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BULGARIA

February 2018

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR BULGARIA

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with Bulgaria, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 14, 2018 consideration of the staff report that concluded the Article IV consultation with Bulgaria.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on February 14, 2018, following discussions that ended on December 14, 2017, with the officials of Bulgaria on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on January 31, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Bulgaria.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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INTERNATIONAL MONETARY FUND
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Press Release No. 18/64
FOR IMMEDIATE RELEASE
February 22, 2018

International Monetary Fund
700 19th Street, NW
Washington, D.C. 20431 USA

IMF Executive Board Concludes the 2017 Article IV Consultation with Bulgaria

On February 14, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Bulgaria.

The Bulgarian economy is performing well. Growth has been on an upward trend and is estimated to reach 3.8 percent in 2017 and 2018, driven by strong exports, easier financial conditions, and growing confidence. The current account remained in surplus in 2017, despite rapid wage growth. The economy shows signs of a closing output gap. Headline inflation turned positive in 2017 and inflationary pressure is rising. The unemployment rate has declined to 5.8 percent, the lowest level since the global financial crisis. Fiscal outcomes have been stronger than budgeted in recent years – a surplus of 0.8 percent of GDP is estimated for 2017 – reflecting mainly revenue overperformance and under-execution of capital spending.

The main challenge is to translate this recent recovery into sustained and inclusive growth and convergence with other EU countries. Bulgaria’s per capita income is only half of the EU average and income inequality is higher than EU average. Growth is projected to moderate to 2¾ percent over the medium, reflecting capacity constraints and unfavorable demographics. Public debt is low, but contingent liabilities and long-term fiscal pressures from demographic challenges could pose fiscal risks over the long run.

Advancing governance reform and improving efficiency of public institutions at all levels remain key to raise potential growth and contain fiscal risks. Reform priorities include improving public infrastructure, enhancing quality of and access to education and healthcare, addressing skill mismatches in the labor market, and strengthening management and oversight of state-owned enterprises. The banking system is resilient, but NPLs remain well

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

above the EU average and two of the banks identified by the asset quality review and stress test still require larger capital buffers.

Executive Board Assessment[2]

Executive Directors agreed with the thrust of the staff appraisal. They welcomed Bulgaria's strong macroeconomic performance and commended the authorities for their prudent policy management. Directors noted that despite the significant progress, challenges remain. They encouraged the authorities to use the current supportive economic environment to focus on improving public goods provision, addressing the fiscal challenges posed by unfavorable demographic prospects, and strengthening governance and labor markets to accelerate income convergence to EU levels.

Directors welcomed the current fiscal policy stance and considered the authorities' budget deficit target for 2018 to be appropriate, given the need for more public investment. They also endorsed the plan to balance the budget over the medium term. Directors generally agreed that saving revenue overperformance would help avoid adding excessive fiscal stimulus and build fiscal buffers. A number of Directors emphasized that fiscal consolidation should be growth friendly and uphold the much-needed capital as well as social spending. Directors underscored the importance of enhancing spending efficiency and effectiveness, including for EU funds. They noted the need for continued attention to fiscal challenges related to population aging.

Directors commended the efforts to strengthen financial supervision. They welcomed the implementation of the FSAP recommendations and the work underway to operationalize the new crisis management arrangements. They welcomed the improved governance structure at the Bulgarian National Bank and encouraged effective implementation. Directors encouraged the authorities to complete other ongoing work, including addressing concentration and related party risks and introducing a comprehensive strategy for NPL reduction. Progress on these fronts will further strengthen financial stability and support better governance. Credible new investment should be finalized promptly for two banks which have been identified as needing larger capital buffers, while meeting the regulatory capital requirement.

Directors emphasized that structural reforms aimed at improving the quality of education and health, enhancing oversight and performance of state-owned enterprises, and strengthening governance are critical to boost productivity and competitiveness, and promote sustained inclusive growth. In this regard, they agreed that more equitable access to education and better targeting of active labor market policies will be important. Directors welcomed recent

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

reforms to improve the judiciary and the fight against corruption, and highlighted that further efforts in this area will create an environment more conducive to private investment.

Bulgaria: Selected Economic and Social Indicators, 2013–18

	2013	2014	2015	2016	2017	2018
					Est.	Proj.
Output, prices, and labor market (percent change, unless otherwise indicated)						
Real GDP	0.9	1.3	3.6	3.9	3.8	3.8
Real domestic demand	-1.9	2.6	3.5	1.7	4.6	4.6
Consumer price index (HICP, average)	0.4	-1.6	-1.1	-1.3	1.2	2.0
Consumer price index (HICP, end of period)	-0.9	-2.0	-0.9	-0.5	1.8	2.1
Employment	-0.2	1.3	1.6	-0.6	3.9	0.1
Unemployment rate (percent of labor force)	13.0	11.5	9.2	7.7	6.3	6.0
Nominal wages	6.0	6.0	6.8	8.0	9.5	7.0
General government finances (percent of GDP)						
Revenue	33.8	33.7	35.0	34.7	34.0	34.9
Expenditure	35.5	37.3	37.8	33.1	33.2	35.8
Balance (net lending/borrowing on cash basis)	-1.8	-3.6	-2.8	1.6	0.8	-1.0
External financing	-0.8	6.9	1.6	3.7	-2.2	0.2
Domestic financing	2.6	-1.5	-1.1	-0.6	1.4	0.8
Gross public debt	17.2	26.4	25.6	27.4	23.9	23.5
Money and credit (percent change)						
Broad money (M3)	8.9	1.1	8.8	7.6	7.7	7.9
Domestic private credit	0.3	-7.7	-1.6	1.8	4.6	5.8
Interest rates (percent)						
Interbank rate, 3-month SOFIBOR	1.1	0.8	0.5	0.2	0.1	...
Lending rate (loans to households)	8.4	7.8	6.9	5.9	5.0	...
Balance of payments (percent of GDP, unless otherwise indicated)						
Current account balance	1.3	0.1	0.0	5.3	3.8	2.9
Capital account balance	1.1	2.2	3.1	2.2	1.2	1.7
Financial account balance	3.4	-4.9	-1.6	1.7	1.8	2.2
o/w: Foreign direct investment balance	-3.0	-2.1	-5.1	-0.7	-0.6	-0.7
International investment position	-73	-75	-61	-47	-43	-36
o/w: Gross external debt	88	92	74	71	63	61
o/w: Gross official reserves	34	39	45	50	47	47
Exchange rates						
Leva per euro	Currency board peg to euro at lev 1.95583 per euro					
Leva per U.S. dollar (end of period)	1.4	1.6	1.8	1.9	1.6	...
Real effective exchange rate (percent change)	1.3	-0.5	-3.1	0.2	2.1	...

Social indicators (reference year in parentheses):

Per capita GNI (2016): US$ 7,580; income distribution (Gini index, 2014): 37.4; poverty rate (2014): 22.0 percent.

Primary education completion rate (2015): 98.1 percent.

Births per woman (2015): 1.5; mortality under 5 (per 1,000) (2016): 7.6; life expectancy at birth (2015): 74.5 years.

Sources: Bulgarian authorities; World Development Indicators, The World Bank; and IMF staff estimates.

BULGARIA

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

January 31, 2018

KEY ISSUES

Context. Bulgaria has made major progress since joining the European Union (EU) ten years ago despite being hit by the global and Euro-area crises. However, per capita income is still only half of the EU average and more than one in five people is at risk of poverty. The economy is recovering strongly, with the fiscal and external current account balances in surplus. The main challenge is to translate this recovery into sustained and inclusive economic growth amid unfavorable demographic trends. This will require continued efforts to improve government as well as further strengthening financial stability.

Key policy issues: The Article IV discussions focused on near-term policy actions to improve financial sector stability and medium-term reforms to support growth and fiscal sustainability.

- **Financial sector**. The authorities are making progress in strengthening financial sector oversight in line with the recent Financial System Assessment Program (FSAP) recommendations.[1] The banking system is profitable and has high capital and liquidity ratios. Two banks that require larger capital buffers need to complete credible recapitalization promptly. Actions are also needed to operationalize central bank governance changes and the new crisis management arrangements, further improve bank supervision and regulation, and reduce non-performing loans (NPLs).
- **Fiscal policy**. The fiscal policy stance is broadly appropriate but the efficiency and effectiveness of spending need to improve. Revenue overperformance should be saved to avoid adding excessive fiscal stimulus. Public debt is low, but contingent liabilities and long-term fiscal pressures from unfavorable demographics pose risks. These call for further pension reforms in the future.
- **Structural agenda**. Priority reforms include advancing governance and judicial reforms, and improving the quality of public goods, including education and training and public health. Better oversight and efficiency of state-owned enterprises (SOEs) would raise growth potential as well as reduce fiscal risks.

[1] Bulgaria, Financial System Stability Assessment, IMF, 2017.

Approved By
Jörg Decressin and Yan Sun (SPR)

Discussions were held in Sofia during December 5–14, 2017. The team comprised Messrs. Decressin and Lee (heads), Muraki, Wu, Yehoue (all EUR), Moore (MCM), Miyamoto (FAD), Alexander (STA), Hajdenberg (Resident Representative), and Ms. Vassileva (local Economist). Mr. Manchev (OED) joined some of the meetings. The mission met with Deputy Prime Minister Donchev, Ministers Goranov (Finance), Ananiev (Health), Petkova (Energy), Bulgarian National Bank Governor Radev, other senior officials, and representatives of labor and business organizations, financial institutions, and civil society.

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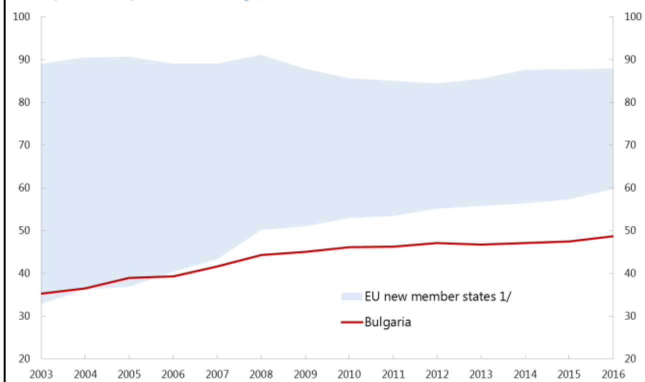
CONTEXT

1. **Bulgaria has made major progress since joining the EU a decade ago but many challenges remain.** Annual per capita GDP growth has averaged 3 percent since 2007 despite the hit from the global and euro-area crises. Health and education indicators have also improved. However, Bulgaria's per capita income is still only half of the EU average, income inequality is higher than EU average and has risen, and the quality of institutions has seen only limited improvement. Furthermore, Bulgaria faces long-term growth and fiscal challenges due to unfavorable demographic prospects—working age population is projected to decline by 26 percent in 30 years.

Income Convergence Has Slowed Since the Global Financial Crisis
(GDP p.c. in PPP in percent of EU average)



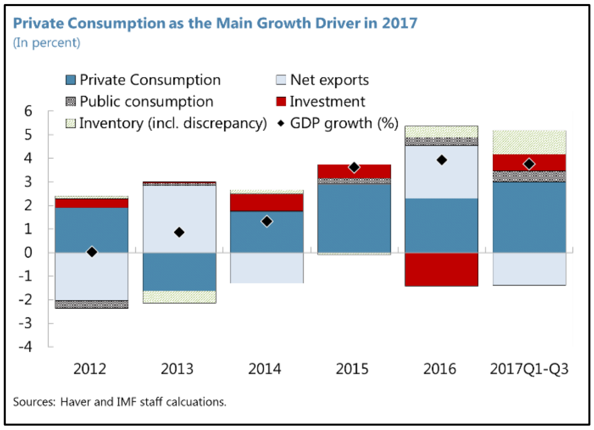
Sources: World Development Indicators; and IMF staff calculations.
1/ EU new member states excluding Bulgaria are: Croatia, Czech Republic, Hungary, Poland, Romania, Slovak Republic, Slovenia, Estonia, Latvia, and Lithuania.

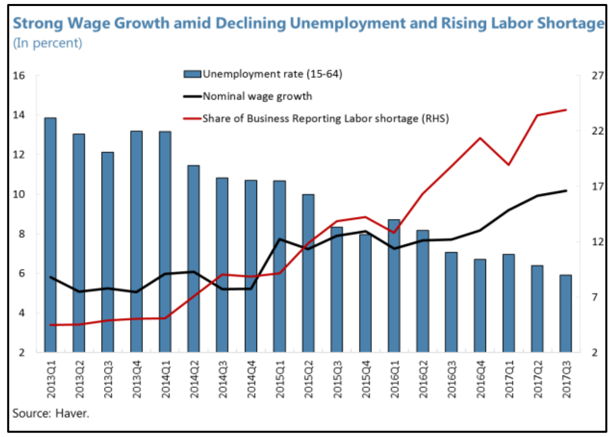
2. **A strong economic recovery has taken hold as Bulgaria has taken over the EU presidency.** The challenge is to translate this recovery into durable and inclusive convergence of people's incomes toward levels prevailing in the richer EU partners. This will require continued action on many fronts, notably increasing the efficiency of public institutions at all levels; remedying weaknesses in education, healthcare, and labor markets; improving the functioning of the judiciary; and further strengthening the financial stability framework. Progress on all these fronts will ultimately help deliver better, more rules-based governance. A short-run policy priority is to further strengthen the resiliency of the financial sector, which was shaken in 2014 by the collapse of the fourth largest bank.[2] The government led by center-right GERB, in office since last May, has put boosting income and infrastructure building as its main priorities.

RECENT DEVELOPMENTS

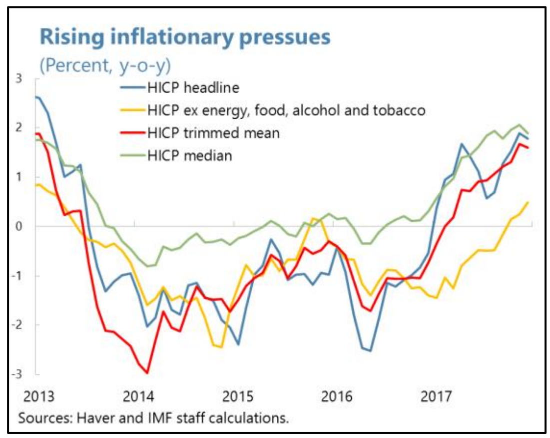
3. **The economy is performing well.** Real GDP growth has been on an upward trend for five consecutive years, reaching 3.8−3.9 percent in 2016 and 2017Q1-Q3, driven by strong exports (in 2016) and a significant increase in tourism arrivals, easier financial conditions, and growing consumer and producer confidence. The unemployment rate has declined to 5.8 percent, the lowest level since the global financial crisis. The fiscal balance moved into a large surplus in 2016, owing to lower public investment, and maintained a surplus in 2017, reflecting revenue overperformance and capital underspending.

[2] The liquidation process for the Corporate Commercial Bank (domestically-owned) is still ongoing.





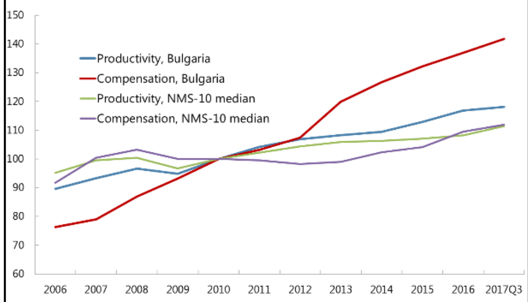
4. There is rising underlying inflationary pressure. Headline inflation turned positive in 2017, reaching 1.8 percent in December buoyed by fuel and food prices and utility tariffs. Core inflation reached 0.5 percent, though still the lowest among the new member states (NMS),[3] held back mostly by declining prices in vehicles and telecommunication services. Other indicators of inflationary pressure (HICP trimmed mean or median) also suggest that pressures are rising, consistent with increasingly rapid wage growth (now around 10 percent) and accelerating import prices. Inflation pressure seems consistent with indicators that signal a closing output gap: low unemployment, high capacity utilization and wage growth, and increasing reports of labor shortages.



5. Despite rapid wage growth (including in the tradable sector), exports have remained competitive. The current account turned into a surplus of 5.3 of percent GDP in 2016, due to strong export growth and lower goods imports, the latter reflecting weak investment and declining import prices. Over January-October 2017, the current account remained at a surplus of 5.3 percent of GDP, helped by robust exports, despite a rebound in imports from the relatively low 2016 levels. Faster wage growth than peers has not yet impaired Bulgaria's export performance—in fact, Bulgaria has continued to gain global goods market share—as local labor costs are still relatively low. But the unit labor cost (ULC)-based real effective exchange rate (REER) is now more than 20 percent higher than before the crisis. Staff judges Bulgaria's external position to be moderately stronger than fundamentals and desirable policy settings (Annex I). External debt declined from a peak of 106 percent of GDP in 2009 to 66 percent of GDP in 2017. Reserves have reached 198 percent of the IMF metric in 2017.

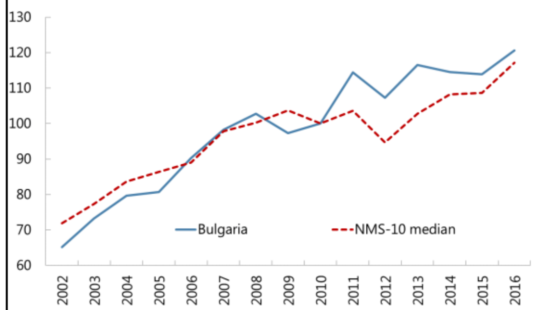
[3] NMS includes Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia.

Real Labor Productivity and Real Compensation Per Employee
(Index 2010 = 100)



Sources: Haver and IMF staff calculations.

Export Market Share (Goods)
(Index 2010 = 100)



Sources: Haver and IMF staff calculations.

6. **The credit cycle continues to lag the economic cycle.** Interest rates are still very low and credit standards have eased for households whose debt stands at 28 percent of GDP. Credit growth, which has also been supported by a government loan subsidy program aimed at improving energy efficiency of residential buildings, has risen from 1.0 percent y/y at end-2016 to 3.2 percent in November 2017.[4] The share of foreign currency lending has declined from 64 percent in 2011 to 38 percent in November 2017. Most banks are very liquid and well capitalized and thus credit supply is not constrained. Credit demand is likely to pick up in line with economic activity, but high non-financial corporate indebtedness continues to stand in the way. While Bulgaria's non-financial corporate debt has declined markedly from 106 percent of GDP in 2008 to 84 percent of GDP in 2016, it remains the highest among the NMS. Staff analysis shows that high corporate debt could be an important drag on investment in Bulgaria (see Selected Issues Paper).

OUTLOOK AND RISKS

7. **GDP growth is projected to remain strong in 2018 (around 3.8 percent) and moderate over the medium term.** The main drivers of growth will be low funding costs; gradually easing credit conditions as banks and firms repair their balance sheets; elevated trading partner growth; and a large pickup in EU-funded capital expenditure. Over the medium term, staff expects growth to slow down to 2¾ percent (3½ percent in per capita terms), reflecting a modest investment recovery (due to elevated corporate debt) and declining working age population. The current account surplus is projected to fall over the medium term as private savings decline. Core inflation is projected to rise in 2018, but headline inflation would remain at around 2 percent, helped by expected lower energy and food price growth.

8. **The risks around the projected, smooth gliding path for the economy are broadly balanced (Annex II).** Too high a wage growth could trigger another boom-bust cycle by fueling higher consumption growth and undermining competitiveness to such an extent that the current account again falls into a deep deficit. Lack of progress in structural reforms to raise productivity and mitigate the impact of aging and emigration could be a drag on potential growth. External risks include a protracted period of slower European growth and rising policy and geopolitical uncertainties. Tightening global financial conditions could weigh on heavily-indebted corporates

[4] These loans will be eventually paid by the budget, and represent 40 percent of the growth of loans to households from October 2016 to October 2017.

and banks with high NPLs. Upside risks include faster-than-expected growth in Europe and substantial progress in structural reforms resulting in faster growth.

Authorities' Views

9. **The authorities expect similar growth in the near term but higher growth over the medium term.** In particular, they see stronger medium-term private investment and productivity growth than the staff. Some among the authorities view a rise in interest rates as a potential source of credit risk. They foresee a limited risk of losing competitiveness.

POLICY DISCUSSIONS

10. **The short-term priority is to continue strengthening the resiliency of the financial system, despite a strong economy that helps reduce vulnerabilities.** Staff sees fiscal policy, notwithstanding some procyclical impulse in the short run, as broadly consistent with a smooth macroeconomic glide path. Over the medium- to long-term, fiscal policy will need to do more to address growing aging-related spending (CR/16/345).

11. **More efficient government and rules-based governance are key to support sustained and inclusive income convergence.** This will require a better use of public expenditure, improved SOE management, including of the Bulgarian Development Bank, and an even stronger financial stability framework. The underlying supervisory policies and practices need to foster a market-based allocation of savings that contributes to stronger and sustained growth, while also serving as a line of defense against corrupt business practices.

A. Prudent Fiscal Policy

12. **Fiscal outcomes have been stronger than budgeted in recent years, reflecting mainly revenue overperformance and under-execution of capital spending.** Staff projects the large 2016 cash surplus (at balance on accrual basis) to decline in 2017 owing to lower EU tranfers. The fiscal outturn through November reached a surplus of 2.4 percent of GDP (compared with an originally projected budget deficit of 1.4 percent of GDP) despite the increases in teachers' wages (Box 1) and in the minimum pension that were not in the original budget (0.2 percent of GDP). Revenues (excluding grants) have continued to overperform the budgeted level, reflecting higher growth, conservative revenue forecasting, and continued revenue collection efforts. Capital spending is lower than budgeted, mainly due to EU-funded projects in 2016, and both domestically-funded and EU-funded projects in 2017. A fiscal surplus of 0.8 percent of GDP is estimated for 2017.

2017 Fiscal Indicators

(In percent of GDP, unless otherwise indicated)

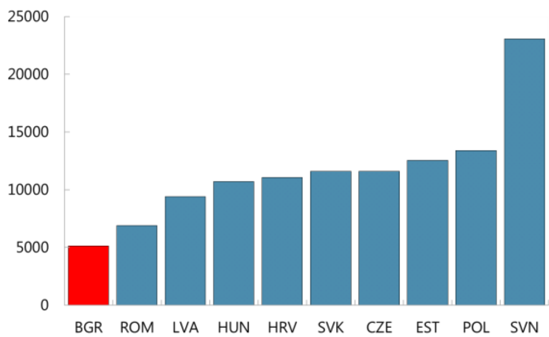
	Budget 1/	Staff Projection
Revenue excl. grants	33.1	32.5
(in millions of leva)	*30,560*	*32,146*
Grants	2.9	1.5
Expenditure	37.4	33.2
Capital expenditures	6.0	3.5
Fiscal balance	-1.4	0.8

Sources: MoF and IMF staff calculations.
1/ Excluding concession for the Sofia Airport which is delayed to 2018.

Box 1. Teachers' Wages

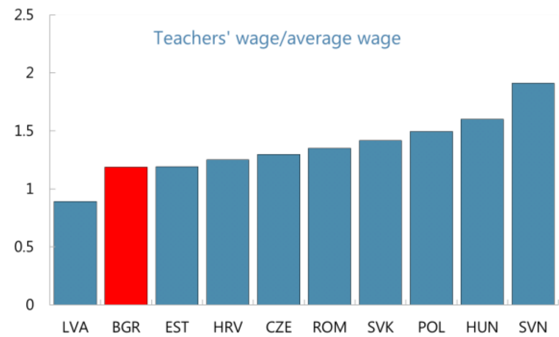
Teachers in Bulgaria are among the lowest-paid in Europe and half of them are close to retirement. The average annual salary of a teacher in Bulgaria was 5,142 euros in academic year 2015/2016. This is the lowest among NMS. The ratio of teachers' wage to the average wage is also lower than peers. Forty-eight percent of the teachers in Bulgaria are 50 years old or older (Eurostat), and will be retiring in the coming years.

Teachers' wages are low in Bulgaria...
(Euro, 2015/16 academic year)



Source: Eurydice (2016).

... though less so in relative terms



Sources: Eurydice (2016) and Eurostat.

To attract new young teachers, the government plans to double the remuneration of pedagogical staffs in pre-, primary-, and secondary schools by the end of 2021. No increase in the number of teachers is envisaged. The wage increase will differ by categories. School principals will determine the wage rates of teachers in the school by negotiating with the teachers' union.

The total cost for doubling the teachers' wage over 2017-2021 is BGN 1.4 billion (1.4 percent of 2017 GDP). In September 2017, teachers' wages were raised by 15 percent on average, which required BGN 80 million. The Ministry of Finance (MoF) will allocate the remaining BGN 1.32 billion, spread equally over 2018-2021.

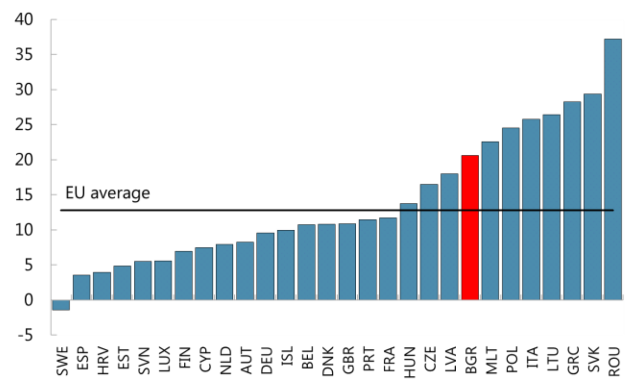
13. The government's fiscal strategy is broadly appropriate.

- The 2018 budget envisages a deficit of 1 percent of GDP (0 percent on accrual basis), appropriately considering the need for more public investment. The largest spending increase is in capital expenditure, reflecting higher EU funds absorption. There are also sizable increases in wages for teachers and defense/security and medical personnel, as well as on public health spending. Revenue measures include further hikes in the social security contribution rate (part of the 2015 pension reforms) and excise duty on cigarettes (to align with the minimum EU levels).

- The revised medium-term budget framework (MTBF) appropriately maintains the target of fiscal balance by 2020. The wage bill for teachers will be doubled between 2017 and 2021 (Box 1), and there will be large spending on military equipment. To offset these spending increases, the wage increase will be moderate for the rest of the public sector; and expenditure on goods and services, capital projects, and social payments will be reduced in percent of GDP. The MTBF also envisages strengthening public spending efficiency and tax collection by taking measures against tax fraud and evasion. Gross public debt would decrease further, to 22 percent of GDP in 2020 (Annex III). The objective of returning to a balanced budget by 2020 is adequate, both on account of cyclical considerations and the need to preserve buffers consistent with the currency board arrangement.

14. If revenues overperform, these could usefully be saved to build up fiscal buffers and avoid adding excessive fiscal stimulus. The authorities' real GDP growth projections appear realistic for the near term and ambitious for the medium term. However, the revenue projections are suitably prudent throughout. There is also room to improve revenue. The authorities could consider designing targeted policies to reduce the value added tax (VAT) gap, and explore the scope to reduce undeclared work (notwithstanding increased labor inspections) and options to efficiently raise revenue, e.g., raising the property tax. If revenues exceed projections in 2018 as is likely, these could usefully be saved to avoid adding excessive fiscal stimulus. Over the medium term, the authorities could target a surplus if revenue overperforms, to strengthen fiscal buffers consistent with the currency board arrangement (CBA) and to address aging-related spending and unanticipated needs that could arise from contingent liabilities. Another reason for a surplus target could be a faster-than-projected acceleration in domestic demand that threatens to cause another boom-bust cycle.

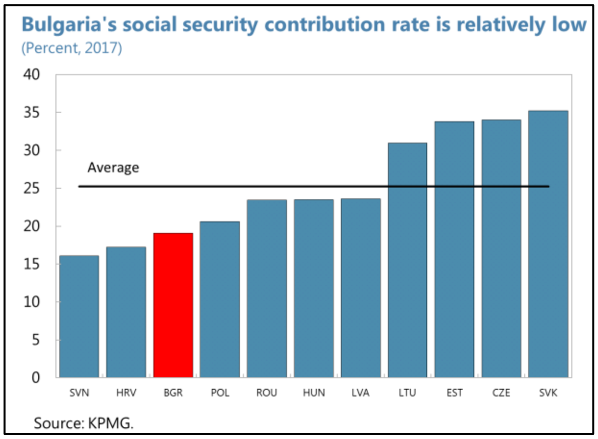
There Is Scope to Reduce VAT Gap
(Percent, 2015)

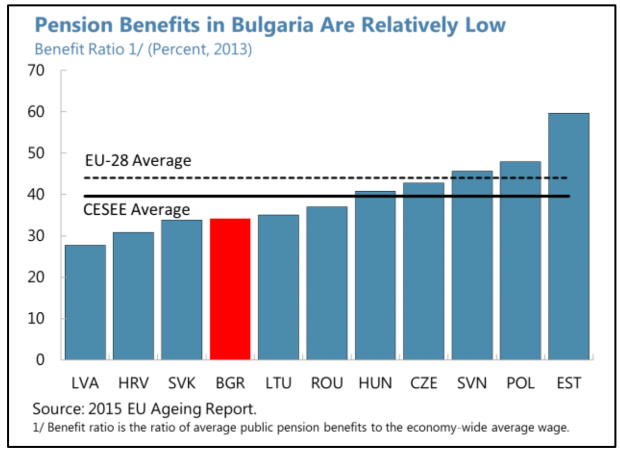


Source: European Commission.

15. Population aging-related fiscal challenges deserve continued attention. Reforms in 2015 raised the social security contribution rate and statutory retirement age, and allowed unlimited transfers between the mandatory private Pillar II and the public Pillar I systems. Bulgaria's statutory retirement ages are expected to remain below the EU medians after reaching 65 years by 2029 for men and by 2037 for women.[5] Staff analysis suggests that further increases in the contribution rate and/or retirement age are eventually needed to ensure the sustainability of the public pension system and prevent an increase in old-age poverty. Staff also advises against unlimited shifts across pillars. While switches from Pillar II to Pillar I would initially lead to an increase in revenue, eventually they could cause an increase in pension expenditure. In addition, the possibility of large withdrawals could force Pillar II funds to hold more short-term and liquid assets with lower returns.

[5] The 2015 reforms introduced an automatic link between the retirement ages and life expectancy once the retirement ages reach 65 years.



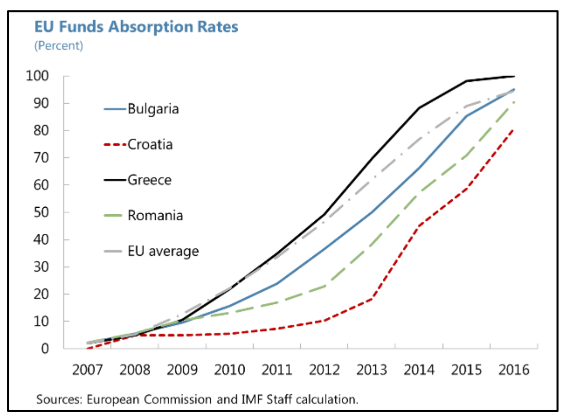


Authorities' views

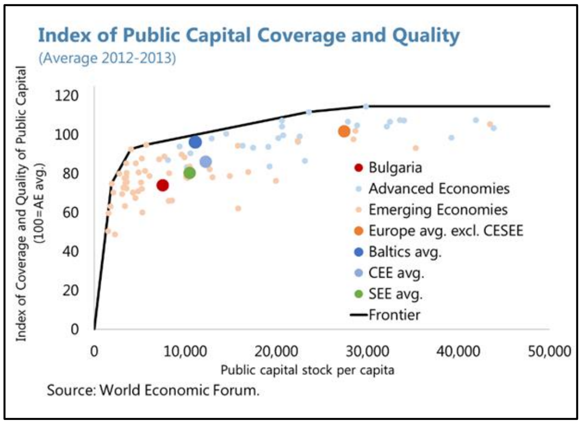
16. **The authorities reiterate their strong commitment to fiscal discipline and building buffers, but note the necessity of allowing transfer between Pillars I and II**. On saving the revenue overperformance, the authorities point out that it could not be spent without amending the budget law. The authorities note that the 2015 social security reform has helped stabilize the pension system and no further action is envisaged at this stage. They understand the mission's concerns about allowing unlimited transfers between Pillar I and Pillar II, but feel that it is necessary because of the mandatory nature of Pillar II and the possibility of Pillar II underperformance. They agree that this may entail a need for additional adjustments to Pillar I parameters but observe that transfers have been small so far (less than one percent of insured persons under Pillar II). The authorities also do not think that the potential for shifts is affecting pension funds' behavior.

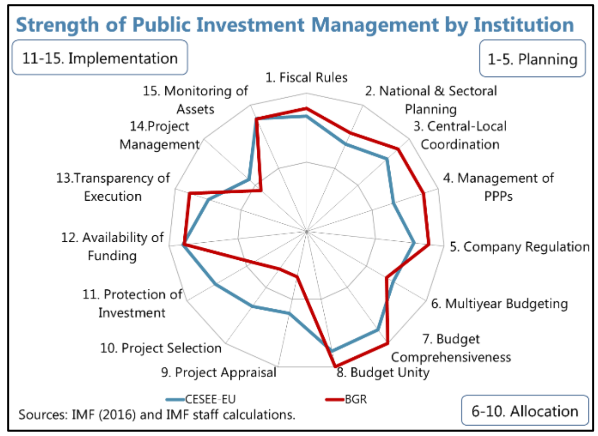
B. Improving Government and Enhancing Growth

17. **Bulgaria's public goods need improvement, which would also enhance potential growth.** In particular, spending efficiency could be improved in general. The World Bank is conducting a public spending review focusing on internal order and security and waste management. The authorities could consider expanding the scope of these reviews.

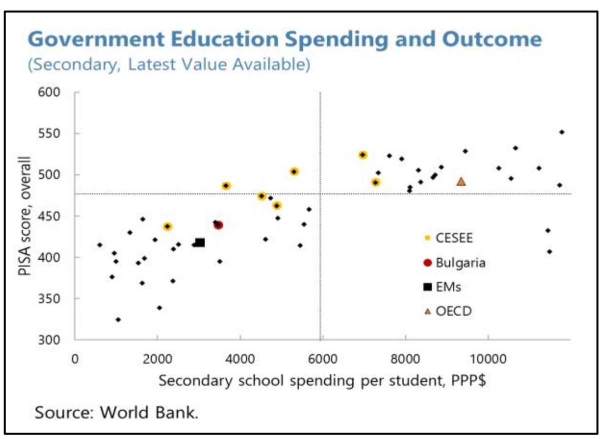


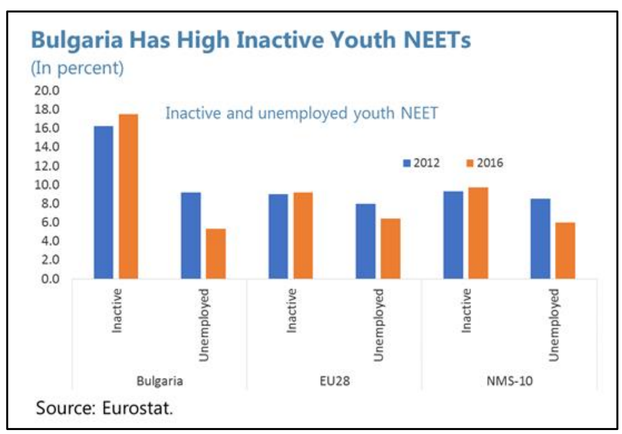
- ***Public infrastructure*** is seen to be lagging in terms of quality. This calls for enhancing capital spending efficiency (see Selected Issues Paper). Staff analysis based on available data suggests that it would require more rigorous and transparent project appraisal and selection. The authorities could conduct a comprehensive public investment management assessment, to help formulate accurate diagnostics. While Bulgaria's EU funds absorption rate in the previous cycle reached 95 percent, in line with peers, it can be further improved including by avoiding heavily back-loaded spending as in the previous round. Strengthening the cooperation between the central government and municipalities would help achieve these objectives.





- ***Education.*** Access to good education and training is essential to address Bulgaria's complex structural challenges, including the deepening shortage of skilled labor. Better and more equal access to quality education are also the best way to enhance equality of opportunity and reduce risks of poverty. Government spending on education remains among the lowest in the EU, and the education system is characterized by outdated curricula and inequality of educational opportunities though there has been a good effort to improve inclusiveness and effectiveness. Staff welcomes recent measures, including performance-based funding for higher education and the pilot programs to improve vocational training in partnership with the business community. Also welcome are the plans to appreciably raise teachers' low salaries to attract young, bright recruits and to better follow up on early school leavers. Pay increases should be linked to performance and reflect the findings of a functional review of public sector employment and wages. Additional efforts are needed to reach vulnerable groups.

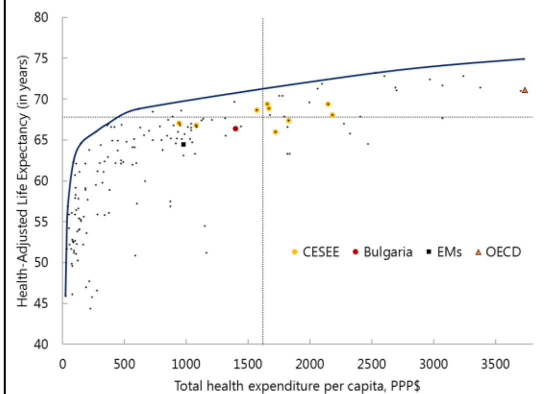




- ***Active labor market policies*** need to be more targeted to address skill mismatches and regional disparities in job opportunities, in order to raise the labor force participation rate, which is lower than the EU average, and reduce the high share of youth NEET (Not in Education, Employment, or Training) and long-term unemployment (Box 2).[6] In this context, recent efforts to reach and activate NEETs and to raise employment in municipalities with high unemployment rate are welcome. To address labor shortages, the authorities are concluding agreements with some countries to allow seasonal workers (mostly in the tourism sector).

- ***Healthcare*** is expensive for the outcomes. Significant efficiency gains could be achieved through better control of the distribution of pharmaceutical drugs and of the contracts between the National Health Insurance Fund and private providers. Public hospitals in a difficult financial situation need to be restructured to ensure service continuity. On a structural basis, the development of the national health map to identify medical needs should be used to alleviate the territorial imbalances in access to medical attention and the excessive reliance on hospitals as opposed to primary and preventive care. Measures will also be needed to address the lack of specialists and replace aging medical personnel.

Health Efficiency Frontier
(Latest Value Available)



Source: WHO.

18. Providing better public goods entails also improving the performance of SOEs.

- Management and oversight of SOEs need strengthening. The policy and ownership functions could usefully be separated and the supervisory boards of SOEs be carefully staffed, while demanding greater accountability. Improving SOE governance and efficiency would also help improve infrastructure quality and raise potential growth, as SOEs are especially important in network industries.

- Contingent liabilities from SOEs also pose medium-term fiscal risks. Nonfinancial SOE debt stands at 8.5 percent of GDP, but around 40 percent of SOEs are making loss. Several SOEs, notably in the energy and transport sectors, have significant debt. More transparency about SOE financial performance is the first step in improving their performance. Staff welcomes the amended Public Finance Act dictates the inclusion of SOE contingent liabilities into the MTBF. Full market liberalization in the energy sector as envisaged could improve the efficiency in the energy market and the

Key FAD TA recommendations on SOE oversight and management

Fiscal risks
The authorities should consider establishing a fiscal risk management unit to identify and analyze SOE fiscal risks.

Legal framework
Most SOEs are exempted from insolvency procedures. Reducing fiscal risks will require amendments to existing insolvency legislation to remove exemptions for SOEs.

Oversight and management
It is important to separate the ownership and policy functions of SOEs. This could be done by transferring the management of all shares in state-level SOEs to a centralized ownership unit.

Corporate governance
The supervisory board should have relevant skills, independent authority and accountability necessary to guide the strategic direction of the company.

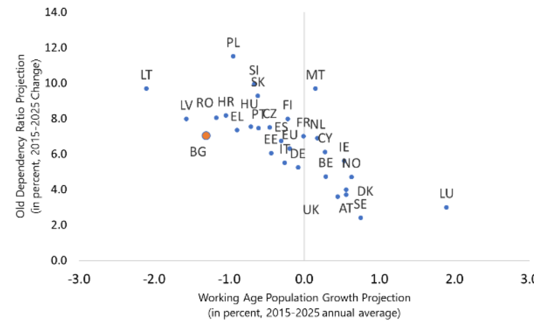
[6] The share of the long-term unemployed in percent of the labor force is low, reflecting the low unemployment rate. However, the share of the long-term unemployed among the unemployed is high at 59.5 percent.

financial viability of the National Electricity Company, while the authorities should also consider providing supports to vulnerable households.

Box 2. Labor Market

Bulgaria is facing a decline in working age population due to aging and emigration. The latest population projections show that from 2015 to 2025 the working age population is expected to decline by 12 percent and the old age dependency ratio is expected to increase by about 7 percentage points. Bulgaria is among the EU countries facing the most severe demographic headwinds.

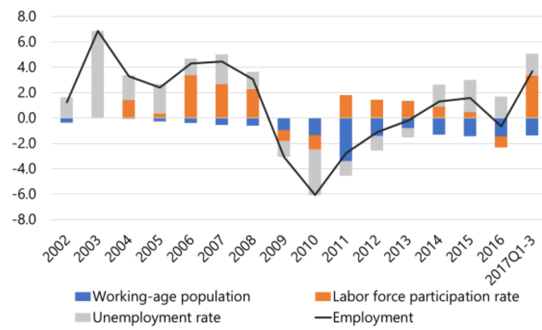
Working Age Population Growth and Old Age Dependency Ratio (2015-2025)



Sources: Eurostat and IMF staff calculations.

Employment growth remained positive in recent years despite its demographic headwinds but challenges lie ahead. Positive employment growth in 2014 and 2015 reflected both the increase in the labor force participation rate and the sizable decline in unemployment rate against a backdrop of the strong economy. However, the unemployment rate is already at the lowest level since the global financial crisis, and labor shortages are becoming a more limiting factor across all sectors.

Employment Growth Decomposition
(In percent)



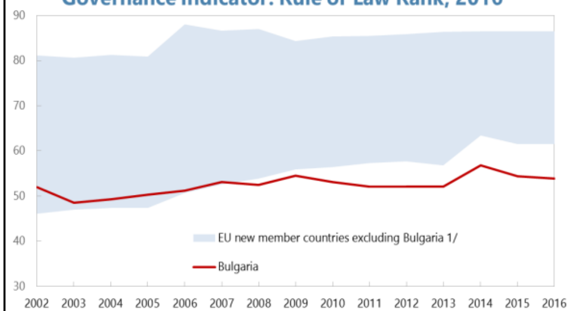
Sources: NSI, Haver and IMF staff calculations.

In the short term, unlocking inactive people, especially young NEETs, is critical to sustain employment growth. The labor force participation rate in Bulgaria was lower than in NMS and the share of NEETs in total population in Bulgaria was the highest among NMS in 2016. While the inactivity rate of middle-aged people has declined since 2012, that of the young changed little, indicating a structural nature of the NEET problem. Lack of qualification and regional disparities in job opportunity lie behind this structural problem. Also, it is important to retain school drop-outs who account for a large share in NEETs (UNICEF 2015), as their proportion is higher than the EU average and rising.

In the medium-term, it is important to address skill mismatches through improving the link between education and the labor market and enhancing the quality of education. The EC Education and Training Monitor 2017 points out mismatches in the labor market: the proportion of higher education graduates working in a position that do not normally require their education degrees is higher than the EU average; and a large part of the students in higher education choose a major in social science, business and law rather than in highly demanded areas such as health care or engineering.

19. A sound judiciary is the most important public good. Judicial reforms and the fight against corruption were already on major public policy agenda in the late 1990s. Progress was made during the EU accession process in improving legislative framework including introducing functional immunity for magistrates, improving efficiency in criminal proceedings, and mandating asset declaration of senior public officials. Nevertheless, the EC concluded that further progress was still needed to meet EU standards, and the Cooperation and Verification Mechanism (CVM) was established in 2007 to monitor progress. Following CVM recommendations, a constitutional amendment was made in 2007, which conferred on the Supreme Judicial Council (SJC) power to appoint, promote and discipline magistrates and created an independent judicial inspectorate to the SJC to monitor the integrity of the judiciary. The 2010 legal amendments gave the SJC the role of assessing workload, amending area of jurisdiction, and reallocating resources in the judiciary, and made integrity assessment a compulsory step in career development and promotion.

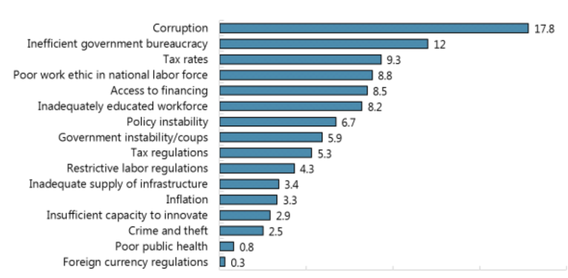
Governance Indicator: Rule of Law Rank, 2016



Source: Worldwide Governance Indicators, Daniel Kaufmann (Natural Resource Governance Institute and Brookings Institution) and Aart Kraay (World Bank).
1/ Croatia, Czech Republic, Hungary, Poland, Romania, Slovak Republic, Slovenia, Estonia, Latvia, and Lithuania.

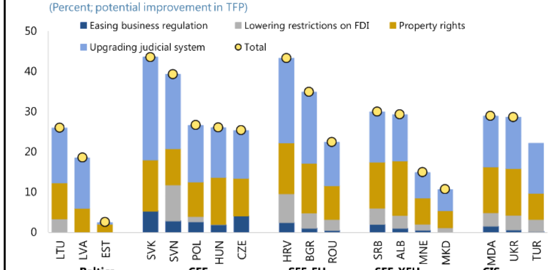
20. More progress is still needed to improve the judiciary, notwithstanding recent reforms. Bulgaria ranks among the weakest performers in the EU on control of corruption and rule of law in the World Bank's Worldwide Governance Indicators. Corruption is also considered the most problematic factor for doing business in Bulgaria by the Global Competitiveness Report. Staff welcomes the broad commitment to further improve the functioning of the judiciary. Important measures have been put in place in recent years, including to enhance the independence and operation of the SJC. The parliament recently passed the Anti-Corruption Act, which includes a provision to establish an anti-corruption body. Efforts are underway to improve the performance of the SJC, to strengthen the effectiveness and accountability of the Prosecutor's Office, and to step up the fight against corruption. The experience of Eastern Europe suggests that the reform of the judiciary can be helped along with a more even distribution of opportunities and resources across society and with increased transparency and accountability.[7] The efforts underway and the measures staff is recommending to improve the efficiency of government and strengthen the financial sector should support further progress in this critical area.

Most Problematic Factors for Doing Business in Bulgaria



Source: World Economic Forum 2017.

CESEE: Estimated Efficiency Gains from Institutional Reforms
(Percent; potential improvement in TFP)



Source: IMF 2016, Regional Economic Issues, Spring.
Notes: Central, Eastern, and Southeastern Europe (CESEE) refers to Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Kosovo, Latvia, Lithuania, the former Yugoslav Republic of Macedonia, Moldova, Montene Romania, Russia, Serbia, the Slovak Republic, Slovenia, Turkey, and Ukraine.

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[7] "Reforming the Judiciary: Learning from the Experience of Central, Eastern and Southeastern Europe" in *Regional Economic Outlook: Europe Hitting Its Stride*, IMF, November 2017.

Authorities' Views

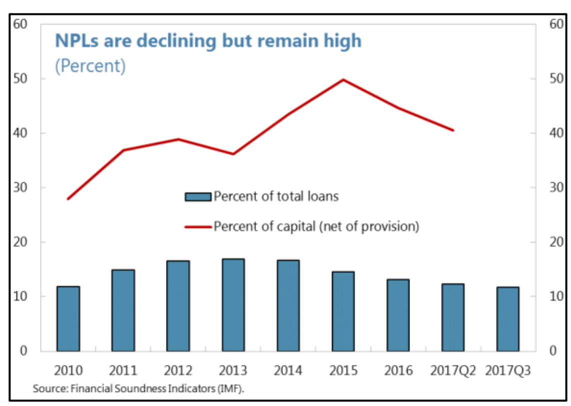
21. **The authorities concur that the main objective now is to increase the effectiveness and efficiency of spending, with a focus on improving education and health care.** They agree that enhancing the effectiveness of EU funds is important and point to reforms such as introducing e-application and e-reporting. Regarding SOE reforms, the authorities disagree with the recommendation to transfer the ownership of all SOEs to the MoF. They argue that the line ministries should maintain the ownership to ensure fulfilling their policy goals, and that the MoF does not have the expertise to supervise all SOEs. The authorities note that publicly-owned banks are subject to the same supervision as private banks. The authorities agree that improving governance is a major task and critical for the economy and would appreciate specific recommendations in future consultations. While not denying the challenge posed by governance, some question the third-party indicators which show that Bulgaria performs poorly all the time regardless of the ebb and flow of reform.

C. A Stronger Financial Sector

22. **The banking system has withstood shocks and the Bulgarian National Bank (BNB) has continued making progress in strengthening bank supervision since the 2014 bank failure.** Prudent supervisory policies have resulted in high system capital ratios that are comfortably above the regulatory minimums, and earnings and liquidity are also strong. However, NPLs remain elevated at more than double the EU average. In line with FSAP recommendations, several legislative initiatives have been introduced, while other steps are in preparation, including implementation.

- ***Governance of the BNB.*** The recent amendment of the Law on Credit Institutions (LCI) has accelerated governance reforms at the BNB by vesting decision making authority at the level of the Governing Council. This welcome broadening of the accountability to the Council, from the deputy governors overseeing banking and payments supervision, should strengthen the central bank's institutional framework. The BNB needs to quickly put in place necessary operating procedures, and ensure that the new collective process does not hamper decision-making.

- ***Addressing NPLs.*** NPLs have declined from 16.9 percent of total loans in 2013 to 11.4 percent in 2017Q3,[8] but are still well above the EU average. The implementation of IFRS 9 in 2018 is likely to lead to a sizable increase in loan loss allowance. Renewed efforts are underway in Europe to tackle NPL problems. In this context, staff welcomes the BNB's supervision department's draft prudential guidance on NPLs that was recently circulated for industry comments, as it incorporates relevant supervisory metrics for credit loss provisioning, NPL accounting write-offs, and collateral valuation. The draft guidance appropriately addresses the legacy NPL stock as well as loans that



[8] Based on the EBA definition. The BNB has traditionally employed a more conservative NPL measure.

fall into default in the future. This approach takes account of important local characteristics that include banks' high capital and profitability, and credit conditions favorable for advancing the adjustments. Importantly, NPL reduction should also require incentivizing banks and debtors to engage in restructuring discussions, further developing the NPL market, and improving the judiciary procedures for debt resolution.

- ***Regulation and supervision.*** The amendments to the LCI also strengthened the definition of related-party exposures and tightened the control over related party exposures to align with EU legislation and country-specific circumstances. It is now important to complete the regulations and supervisory processes/guidance and enforce remedies to address concentration and related party risks on the basis of 2017 and forthcoming inspections. The BNB has also been making other progress in addressing regulation and supervision. It has recently issued a draft risk assessment manual, and is drafting new internal rules on anti-money laundering. The BNB also plans to finalize by 2018Q2 necessary amendments on regulation related to the internal governance rules, following the recently published EBA guidelines. The BNB needs to complete the multi-year action plan with detailed activities to continue strengthening banking supervision.

- ***Financial safety net and crisis management arrangements.*** The authorities have introduced a resolution regime for credit institutions and investment firms in mid-2015, by implementing the EU Bank Recovery and Resolution Directive. The BNB is in the process of operationalizing the new regime. The recently amended Public Finance Act provides a legal framework to support lender of last resort liquidity assistance to a bank consistent with the currency board arrangement, though considerable efforts will still be required procedurally, including that the assistance complies with EU state aid rules.

23. Two of the banks identified by the asset quality review (AQR) and stress test still require larger capital buffers. The 2016 AQR and stress test showed that the banking system overall is resilient, reflecting significant capital and liquidity buffers and the presence of large foreign-owned institutions. However, three domestically-owned banks were identified with capital shortfalls. The smallest of them has raised capital through the conversion of debt into equity and has been put for sale. The other two banks, including a systemically important one, have also raised capital through retained earnings, but would still require larger capital buffers and credible new investment which should be finalized promptly. Sourcing equity from new bona fide investors would help improve credibility and address governance concerns. While the BNB continues to monitor developments and promote capital augmentation for these banks, it needs to adopt a comprehensive supervisory strategy to monitor and ensure their' viability over the medium term.

24. **The authorities have also made welcome legislative progress with regard to the nonbank financial sector,** which is relatively small. The amended Financial Supervision Commission (FSC) Act enables the FSC to fund its budget through levies against supervised entities and improves its independence. The amended Social Insurance Code broadens the definition of related parties (to comply with EU regulation), requiring some pension funds to divest to comply with the new law, which could have a potentially large market impact. The FSC completed a balance sheet review and stress test for the insurance and pension sectors in early 2017, concluding that the investments of the pension funds were properly valued but that capital increases were needed for 13 insurance

companies. Adequate capital was raised by all but two insurers, whose licenses were subsequently revoked.

Authorities' Views

25. **The authorities are satisfied with the FSAP and note that they have made good progress in the areas that are considered necessary.** During the transition period to fully operationalizing the new governance model, the BNB Governing Council will conduct its new supervisory powers within the existing rules and procedures.

D. Integrating Further into the European Union

26. The authorities are contemplating joining ERM II as a first step towards joining the euro area. At least two years in ERM II are required for qualifying to adopt the euro. ERM II transition is likely to be smooth with no change in macro-policy framework, given the strong credibility of Bulgaria's 20-year old CBA. While ERM II allows the currency to fluctuate up to 15 percent above and below the central exchange rate, Bulgaria can opt to unilaterally maintain its CBA with the fixed rate, as Estonia did in 2004. The current real exchange rate level has served Bulgaria well, recently allowing strong external performance.

27. Euro area membership will consummate the commitment of the EU membership which has already come with many benefits and catalyzed reforms. Euro area membership would come with a greater role in the EU's decision making bodies, membership in banking union, and further economic benefits of integration (e.g. heightened confidence, reduced funding costs, and expanded trade). Once in the currency union, exit option is virtually forgone, and Bulgaria would be more exposed to spillover effects from any member's decision on its membership, as well as generating such greater effects on others. This raises the premium of a strong and flexible economy.

STAFF APPRAISAL

28. Bulgaria has achieved considerable progress in the first decade of EU membership. The economy has shown resilience to shocks, and attained comfortable levels of fiscal buffers and international reserves. However, the income gap relative to EU levels is still large and poverty remains high, with little progress in improving governance and reducing income inequality. Furthermore, Bulgaria faces long-term growth and fiscal challenges due to population aging and emigration.

29. The economy is in a strong position. GDP growth has picked up since 2015 and the output gap is closing. Unemployment is at its lowest level in ten years and consumer and business confidence are also near multi-year highs. At the same time, the current account has remained in surplus, as Bulgaria has been able to maintain its external competitiveness despite strong wage growth.

30. Fiscal policy has been appropriately conservative, but long-term fiscal challenges need continued attention. Fiscal outturns have been better than budgeted in recent years, reflecting both revenue overperformance and under-execution of capital spending. The 2018 Budget and the MTBF are broadly appropriate. Revenue overperformance should be saved to avoid adding excessive fiscal stimulus and to build up fiscal buffers. Public debt is low, whereas contingent pension liabilities pose risks over the long run. While much progress has already been achieved, the authorities need to, at some stage, revisit or address the consequences of the policy to allow for the unlimited transfers between Pillar I and Pillar II, and consider raising statutory retirement age and social security contribution rates.

31. Improving public goods provision and SOE performance would help raise potential growth. Enhancing spending efficiency and effectiveness including for EU funds is vital to provide better public goods and to improve Bulgaria's growth prospects. Better education and training and more effective labor market policies could help raise employment and mitigate the adverse effects of population aging and emigration. Enhancing SOE oversight and performance would help raise productivity and contain fiscal risks.

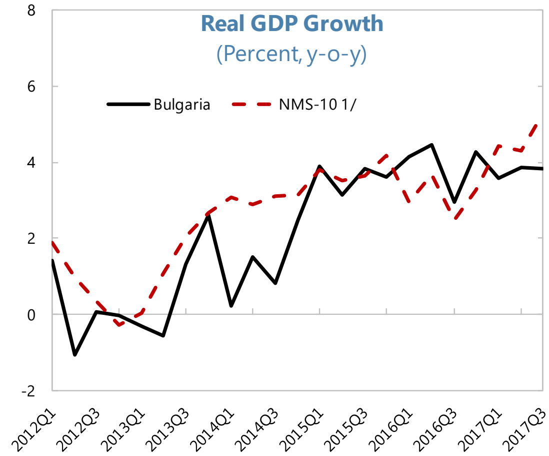
32. Strengthening governance is critical in improving business environment and private investment. The recent reforms to improve the judiciary and the fight against corruption are welcome. Additional efforts are needed to establish a track record in demonstrating judicial independence and effectiveness, and to step up the fight against high-level corruption. More equal distribution of opportunities and resources across society and increased transparency and accountability will help improve institutional quality.

33. Recent efforts to further strengthen financial supervision are welcome and should continue. The authorities have legislated BNB governance changes and the new crisis management arrangements which are being operationalized. The BNB needs to complete ongoing work including on addressing concentration and related party risks and introducing a comprehensive strategy for NPL reduction. Two domestically-owned banks require larger capital buffers and credible new investment should be finalized promptly.

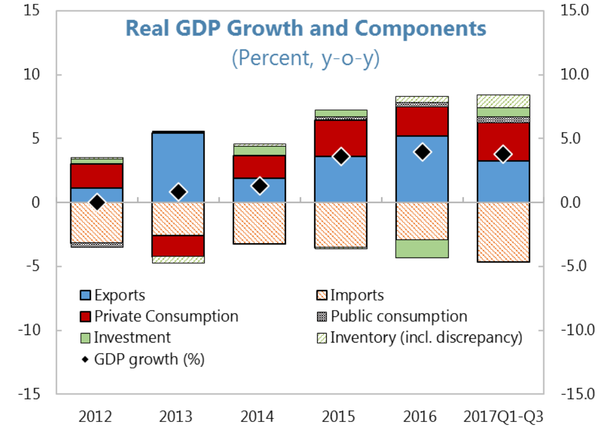
34. It is proposed that Bulgaria remain on the standard 12-month Article IV cycle.

Figure 1. Bulgaria: Real Sector Developments, 2012-17

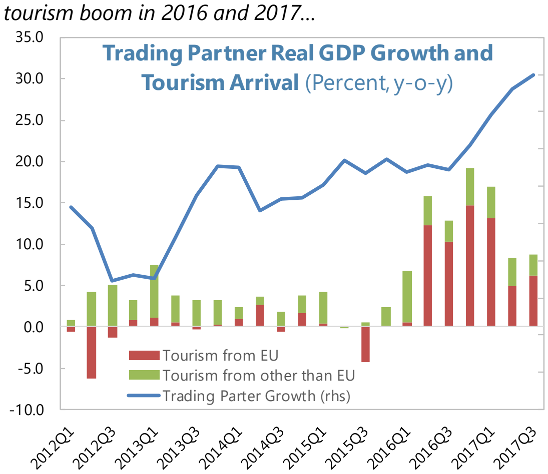
Strong growth in recent years was largely in line with the regional peers…



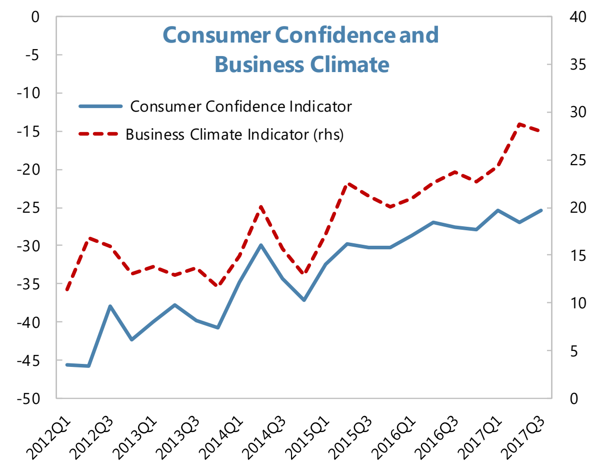
…led by private consumption and export growth…



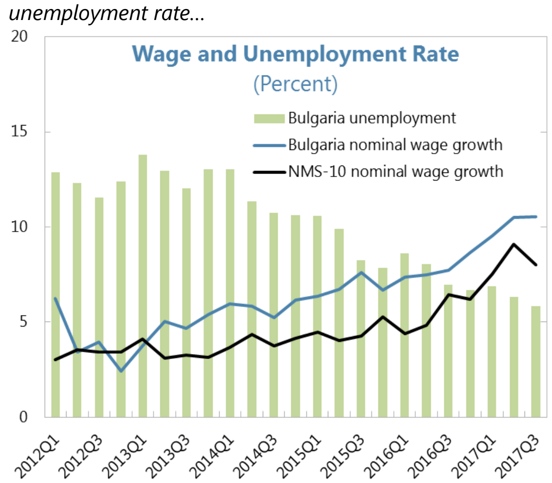
…benefitting from economic recovery in trading partners, a tourism boom in 2016 and 2017…



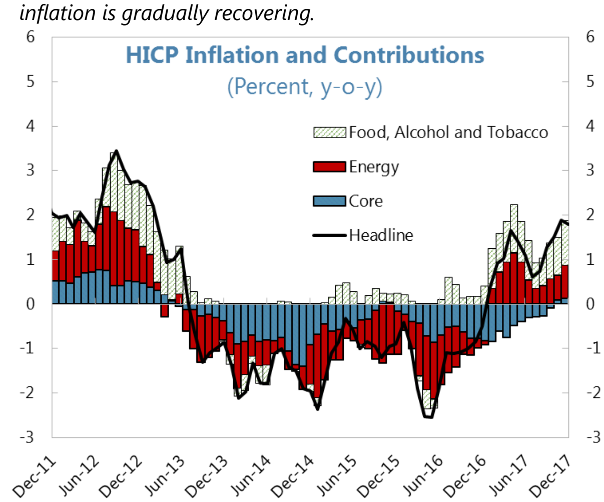
…and improving consumer confidence and business climate.



Nominal wage has grown faster than in peers amid declining unemployment rate…



…and inflation entered positive territory in 2017 and core inflation is gradually recovering.

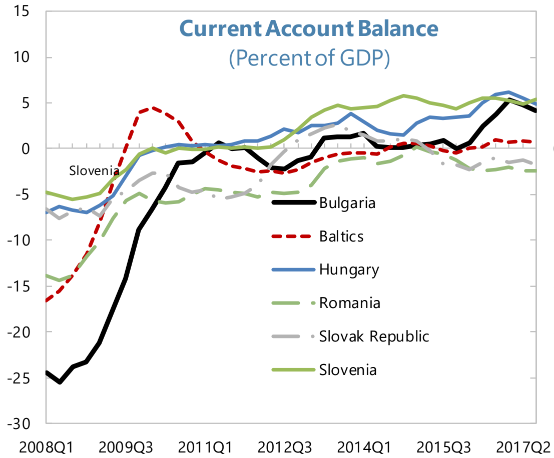


Sources: Haver Analytics, National authorities, and IMF staff calculations.

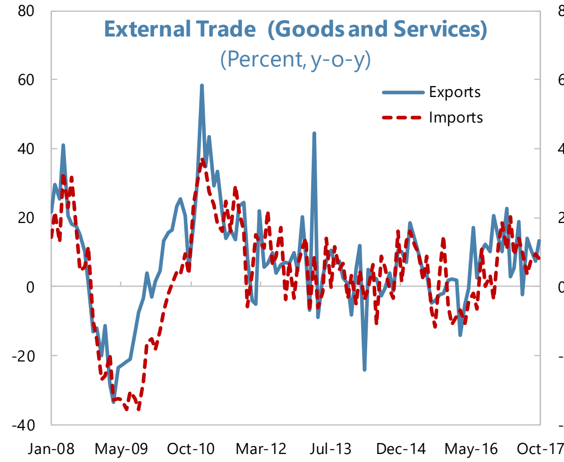
1/ NMS-10: Estonia, Latvia, Lithuania, Croatia, Czech Republic, Hungary, Poland, Slovak Republic, Slovenia and Romania.

Figure 2. Bulgaria: External Sector Developments, 2008-17

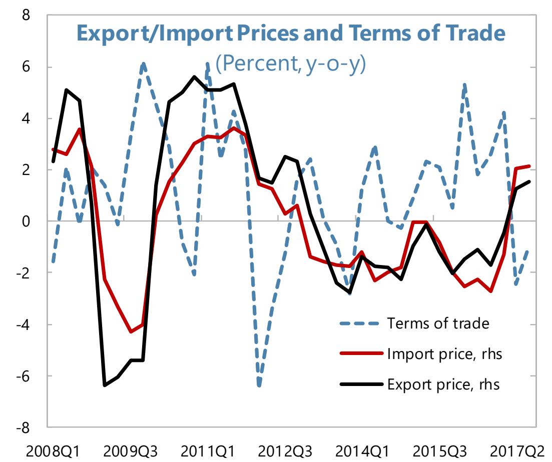
The current account surplus rose sharply in 2016 and maintained this trend in 2017 in line with tourism as ...



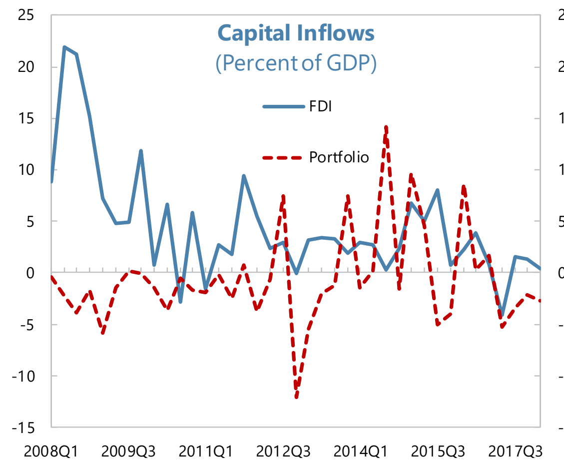
...imports were broadly flat in 2016 while exports grew strongly...



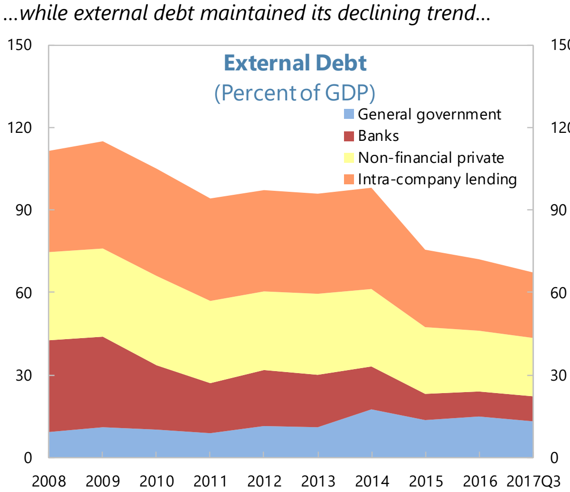
...while the terms of trade sharply improved, although they deteriorated in 2017H1.



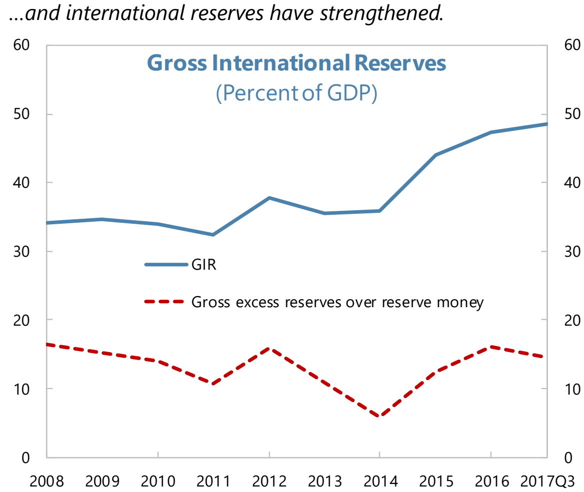
Capital inflows have moderated recently...



...while external debt maintained its declining trend...



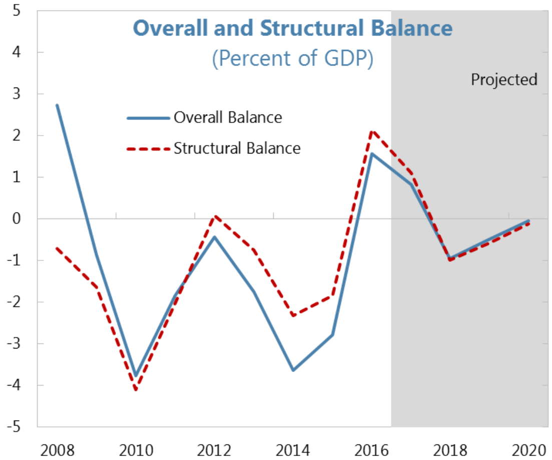
...and international reserves have strengthened.



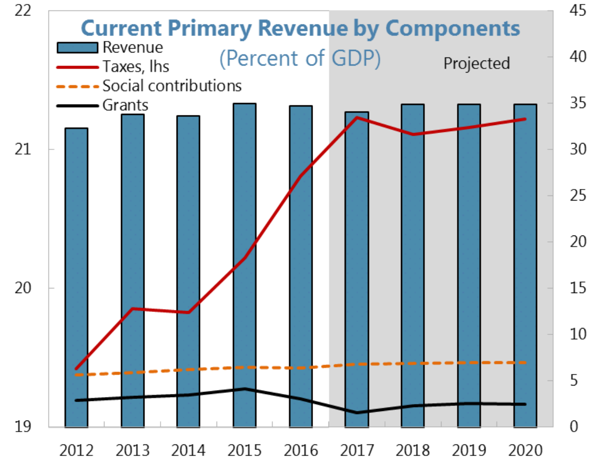
Sources: Haver Analytics, National authorities, and IMF staff calculations.

Figure 3. Bulgaria: Fiscal Developments, 2008-20

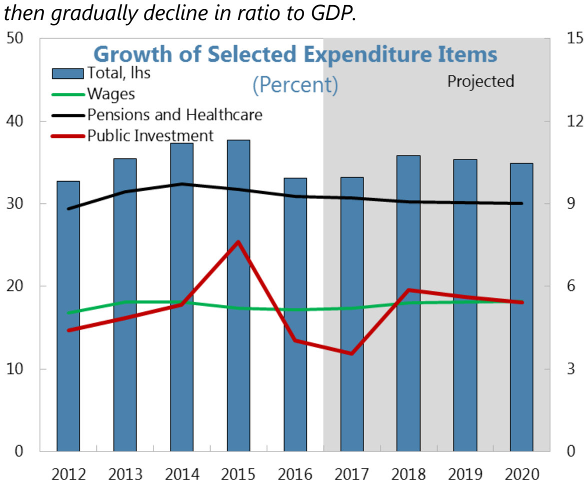
The budget balance in 2016 was positive for the first time since 2009...



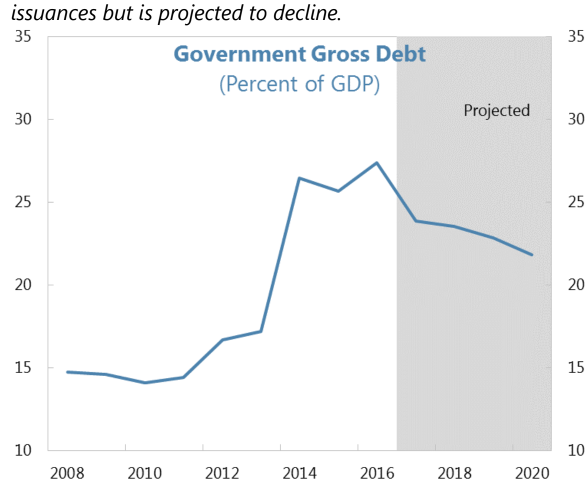
...due to strong revenue performance, particularly tax proceeds.



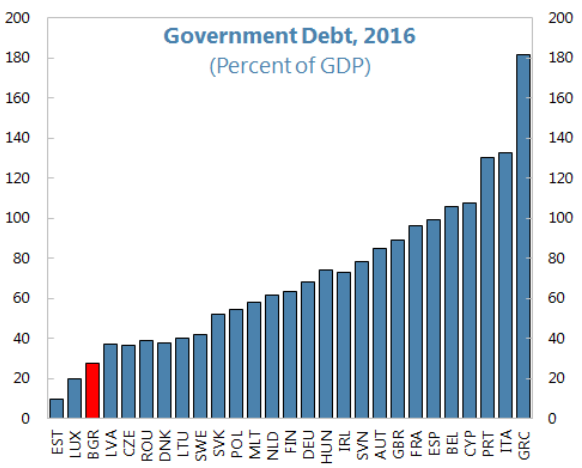
Expenditure is expected to increase markedly in 2018 and then gradually decline in ratio to GDP.



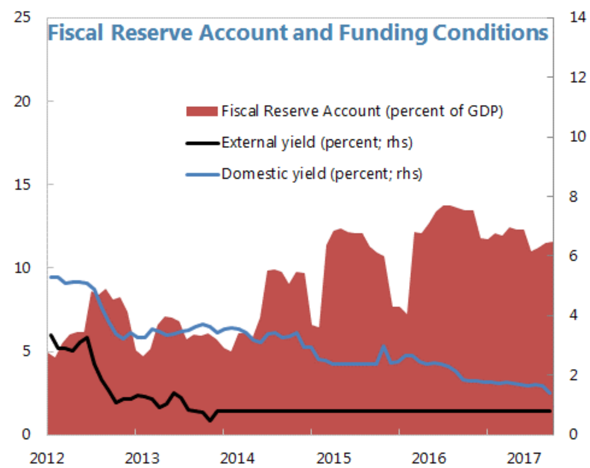
Public debt increased temporarily in 2016 due to Eurobond issuances but is projected to decline.



Bulgaria's debt remains among the lowest in the EU.



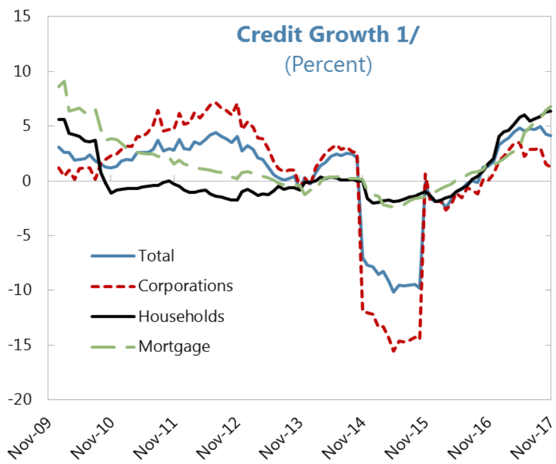
Fiscal reserve declined in 2017 due to Eurobond repayment.



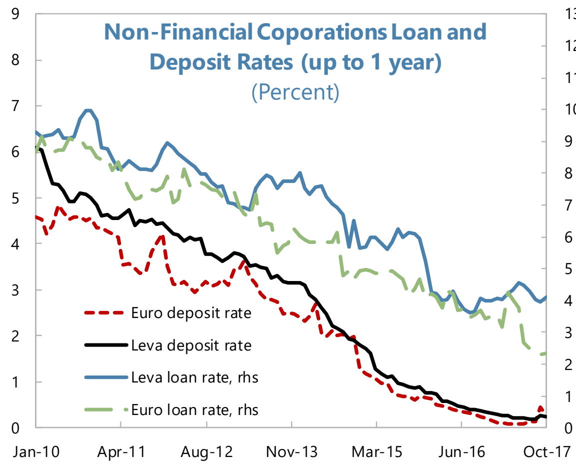
Sources: Eurostat, National authorities, and IMF staff estimates.

Figure 4. Bulgaria: Monetary and Financial Sector Developments, 2008-17

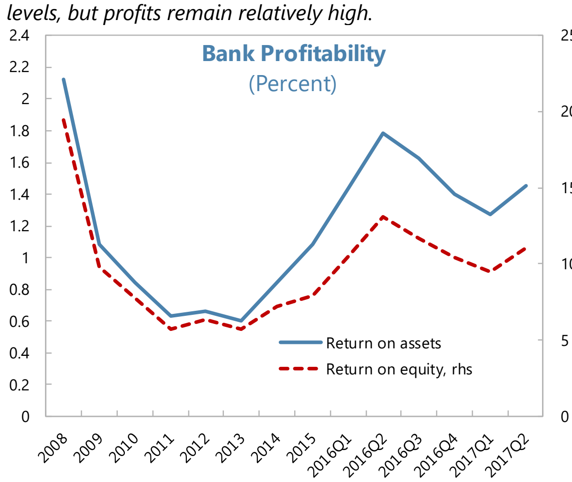
Credit growth has started to recover…



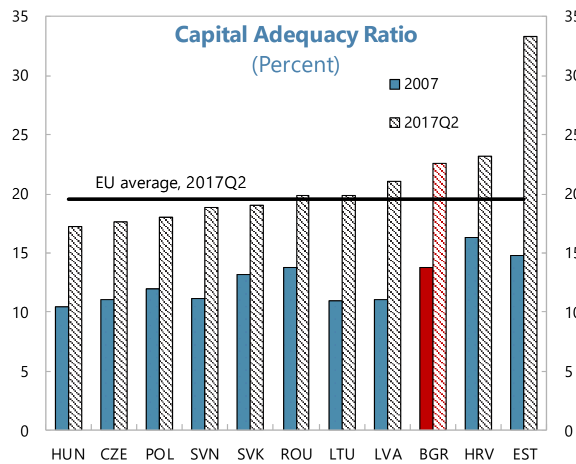
…partially supported by declining interest rates.



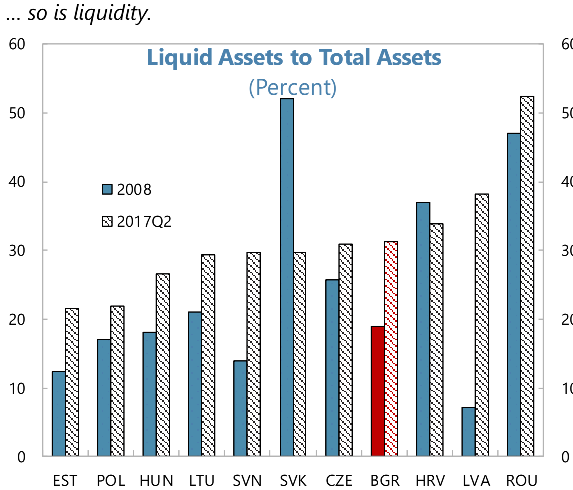
Lower interest rates reduced bank profitability from the 2016 levels, but profits remain relatively high.



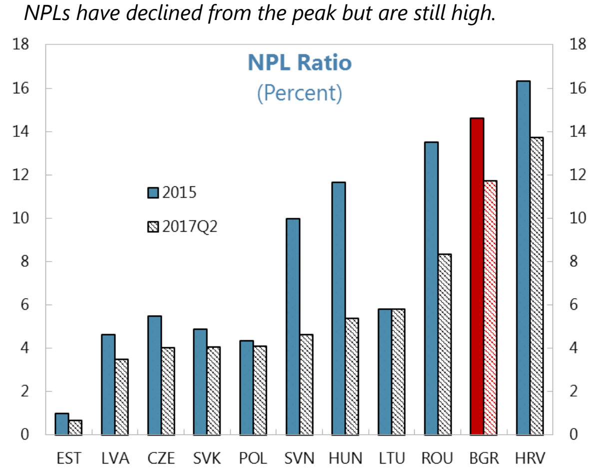
Capital remains high…



… so is liquidity.



NPLs have declined from the peak but are still high.



Note: Bulgaria's data is 2017 Q3.

Sources: BNB, IMF FSI, and IMF staff calculations.

1/ Due to the revocation of the banking license of KTB, the bank is excluded as a reporting agent from the monetary statistics data used in the panel charts staring in November 2014.

Table 1. Bulgaria: Selected Economic Indicators, 2013–22

(Annual percentage change, unless noted otherwise)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Est.			Proj.		
Real GDP	0.9	1.3	3.6	3.9	3.8	3.8	3.1	2.8	2.8	2.8
Real domestic demand	-1.9	2.6	3.5	1.7	4.6	4.6	4.1	3.6	3.2	3.2
Public consumption	0.6	0.1	1.4	2.2	4.2	4.6	4.2	3.6	3.0	3.0
Private consumption	-2.5	2.7	4.5	3.5	4.7	4.1	3.8	3.6	3.3	3.3
Gross capital formation	-2.1	4.2	2.2	-4.3	4.4	6.6	4.7	3.3	3.1	3.1
Private investment	-2.6	0.3	-3.7	-1.6	4.1	3.3	3.3	3.3	3.3	3.3
Public investment	11.4	14.0	21.4	-18.4	-8.9	18.2	9.5	3.8	3.1	3.1
Stock building 1/	-0.5	0.2	-0.1	0.5	0.7	0.0	0.0	0.0	0.0	0.0
Net exports 1/	2.8	-1.3	0.1	2.2	-0.8	-0.9	-1.0	-0.9	-0.5	-0.5
Exports of goods and services	9.6	3.1	5.7	8.1	4.9	4.4	4.0	3.7	3.6	3.4
Imports of goods and services	4.3	5.2	5.4	4.5	6.1	5.7	5.4	4.8	4.1	3.9
Resource utilization										
Potential GDP	2.1	2.2	2.5	3.0	3.0	2.9	2.9	2.9	2.9	2.9
Output gap (percent of potential GDP)	-2.8	-3.6	-2.5	-1.6	-0.8	0.1	0.3	0.2	0.1	0.0
Unemployment rate (percent of labor force)	13.0	11.5	9.2	7.7	6.3	6.0	5.8	5.6	5.5	5.5
Price										
GDP deflator	-0.7	0.5	2.2	2.2	1.2	2.0	2.1	2.1	2.1	2.1
Consumer price index (HICP, end of period)	-0.9	-2.0	-0.9	-0.5	1.8	2.1	2.1	2.1	2.1	2.1
Fiscal indicators (percent of GDP)										
General government net lending/borrowing (cash basis)	-1.8	-3.6	-2.8	1.6	0.8	-1.0	-0.5	0.0	0.0	0.0
General government primary balance	-0.9	-3.0	-2.0	2.3	1.6	-0.3	0.2	0.6	0.7	0.7
Structural overall balance	-0.7	-2.3	-1.8	2.1	1.1	-1.0	-0.6	-0.1	0.0	0.0
Structural primary balance	0.1	-1.6	-1.1	2.9	1.9	-0.3	0.1	0.6	0.7	0.7
General government gross debt 2/	17.2	26.4	25.6	27.4	23.9	23.5	22.8	21.8	20.7	19.7
Monetary aggregates 3/										
Broad money	8.9	1.1	8.8	7.6	7.7	7.9	7.4	7.0	7.0	7.0
Domestic private credit	0.3	-7.7	-1.6	1.8	4.6	5.8	6.1	6.2	6.7	6.7
Exchange rates regime										
Leva per U.S. dollar (end of period)	1.4	1.6	1.8	1.9	1.6	...	...	...	...	...
Nominal effective rate	2.5	2.9	-1.2	2.5	3.0	...	...	...	...	...
External sector (percent of GDP)										
Current account balance	1.3	0.1	0.0	5.3	3.8	2.9	2.1	1.3	0.6	0.3
o/w: Merchandise trade balance	-7.0	-6.5	-5.8	-2.0	-2.4	-2.8	-3.0	-3.3	-3.4	-3.5

Sources: Bulgarian authorities; World Development Indicators; and IMF staff estimates.

1/ Contribution to GDP growth.

2/ In projection period, largely reflects issuance and repayment of eurobonds.

3/ Due to the revocation of the banking license of KTB, the bank is excluded as a reporting agent from the monetary statistics data starting in November 2014.

Table 2. Bulgaria: Macroeconomic Framework, 2013–22

(Annual percentage change, unless noted otherwise)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Est.			Proj.		
GDP and prices										
Real GDP	0.9	1.3	3.6	3.9	3.8	3.8	3.1	2.8	2.8	2.8
Real GDP per working age population	1.7	2.7	5.1	5.5	5.2	4.9	4.1	3.8	3.7	3.7
Real GDP per capita	1.4	1.9	4.3	4.7	4.4	4.4	3.7	3.4	3.4	3.4
Real domestic demand	-1.9	2.6	3.5	1.7	4.6	4.6	4.1	3.6	3.2	3.2
Of which: private	-2.5	2.7	4.5	3.5	4.7	4.1	3.8	3.6	3.3	3.3
GDP deflator	-0.7	0.5	2.2	2.2	1.2	2.0	2.1	2.1	2.1	2.1
Consumer price index (HICP, average)	0.4	-1.6	-1.1	-1.3	1.2	2.0	2.1	2.1	2.1	2.1
Nominal wages	6.0	6.0	6.8	8.0	9.5	7.0	5.7	5.0	4.8	4.8
Real effective exchange rate, CPI based	1.3	-0.5	-3.1	0.2	2.1	...	...	...	...	...
Monetary aggregates (percent change) 1/										
Broad money	8.9	1.1	8.8	7.6	7.7	7.9	7.4	7.0	7.0	7.0
Domestic private credit	0.3	-7.7	-1.6	1.8	4.6	5.8	6.1	6.2	6.7	6.7
Saving and investment (percent of GDP)										
Foreign saving	-1.3	-0.1	0.0	-5.3	-3.8	-2.9	-2.1	-1.3	-0.6	-0.3
Gross national saving	22.6	21.5	21.2	24.5	22.8	22.5	21.5	20.7	20.0	19.7
Government	3.1	1.7	4.8	5.6	4.4	4.9	5.1	5.4	5.4	5.5
Private	19.5	19.8	16.3	18.9	18.4	17.6	16.4	15.3	14.6	14.3
Gross domestic investment	21.3	21.4	21.2	19.1	19.1	19.6	19.5	19.4	19.4	19.4
Government	4.8	5.3	7.6	4.0	3.5	5.9	5.6	5.4	5.4	5.4
Private	16.5	16.1	13.6	15.1	15.5	13.8	13.9	14.0	14.0	14.0
General government (percent of GDP)										
Revenue	33.8	33.7	35.0	34.7	34.0	34.9	34.8	34.8	34.9	35.0
Tax revenue (including social security contributions)	25.7	26.0	26.7	27.2	28.0	28.0	28.1	28.1	28.1	28.1
Non-Tax revenue	4.8	4.1	4.2	4.4	4.5	4.6	4.2	4.2	4.2	4.2
Grants	3.2	3.5	4.1	3.1	1.5	2.3	2.5	2.5	2.6	2.6
Expenditure	35.5	37.3	37.8	33.1	33.2	35.8	35.3	34.9	34.9	34.9
Balance (net lending/borrowing on cash basis)	-1.8	-3.6	-2.8	1.6	0.8	-1.0	-0.5	0.0	0.0	0.0
Structural balance	-0.7	-2.3	-1.8	2.1	1.1	-1.0	-0.6	-0.1	0.0	0.0
Balance of payments (percent of GDP)										
Current account	1.3	0.1	0.0	5.3	3.8	2.9	2.1	1.3	0.6	0.3
Trade balance	-7.0	-6.5	-5.8	-2.0	-2.4	-2.8	-3.0	-3.3	-3.4	-3.5
Services balance	6.3	5.9	6.6	6.4	6.2	5.8	5.6	5.3	5.1	4.9
Primary income balance	-3.8	-3.1	-4.5	-2.4	-2.6	-2.8	-3.1	-3.2	-3.5	-3.6
Secondary income balance	5.7	3.8	3.6	3.3	2.5	2.6	2.6	2.5	2.5	2.5
Capital and financial account	-2.3	7.1	4.8	0.5	-0.6	-0.5	-0.6	-0.3	-0.1	0.2
Of which: Foreign direct investment	-3.0	-2.1	-5.1	-0.7	-0.6	-0.7	-0.8	-1.0	-1.1	-1.2
Memorandum items:										
Gross international reserves (billions of euros)	14.4	16.5	20.3	23.9	23.7	24.9	25.8	26.4	26.7	27.0
Short-term external debt (percent of GDP) 2/	22.8	23.3	16.3	15.4	14.0	14.1	13.8	13.7	13.9	13.5
Export volume (goods, percent change)	11.8	1.4	6.7	7.9	6.0	4.8	4.3	4.1	4.0	3.8
Import volume (goods, percent change)	5.0	1.5	6.2	4.5	6.5	5.9	5.4	4.9	4.2	4.0
Terms of trade (percent change)	-0.3	1.0	1.5	3.5	0.1	0.0	0.7	0.2	0.0	0.0
Output gap (percent of potential GDP)	-2.8	-3.6	-2.5	-1.6	-0.8	0.1	0.3	0.2	0.1	0.0
Nominal GDP (millions of leva)	82,166	83,634	88,571	94,130	98,868	104,664	110,175	115,638	121,372	127,391
Nominal GDP (millions of euros)	42,011	42,762	45,286	48,128	50,550	53,514	56,331	59,125	62,057	65,134

Sources: Bulgarian authorities; and IMF staff estimates.

1/ Due to the revocation of the banking license of KTB, the bank is excluded as a reporting agent from the monetary statistics data starting in November 2014.

2/ At original maturity.

Table 3. Bulgaria: Real GDP Components, 2013–22
(Annual percentage change, unless noted otherwise)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Est.			Proj.		
					(Real growth rate, in percent)					
GDP	0.9	1.3	3.6	3.9	3.8	3.8	3.1	2.8	2.8	2.8
Domestic demand	-1.9	2.6	3.5	1.7	4.6	4.6	4.1	3.6	3.2	3.2
Private demand	-3.1	2.4	2.7	3.2	5.5	3.9	3.7	3.6	3.2	3.2
Public demand	2.9	3.3	6.5	-3.8	1.0	7.7	5.5	3.7	3.0	3.1
Final consumption	-1.9	2.2	3.8	3.3	4.7	4.2	3.9	3.6	3.2	3.2
Private consumption	-2.5	2.7	4.5	3.5	4.7	4.1	3.8	3.6	3.3	3.3
Public consumption	0.6	0.1	1.4	2.2	4.2	4.6	4.2	3.6	3.0	3.0
Investment	-2.1	4.2	2.2	-4.3	4.4	6.6	4.7	3.3	3.1	3.1
Gross fixed investment	0.3	3.4	2.7	-6.6	0.7	6.9	4.9	3.4	3.2	3.2
Private investment	-2.6	0.3	-3.7	-1.6	4.1	3.3	3.3	3.3	3.3	3.3
Public investment	11.4	14.0	21.4	-18.4	-8.9	18.2	9.5	3.8	3.1	3.1
Inventories 1/	-0.5	0.2	-0.1	0.5	0.7	0.0	0.0	0.0	0.0	0.0
Net exports 1/	2.8	-1.3	0.1	2.2	-0.8	-0.9	-1.0	-0.9	-0.5	-0.5
Exports of goods and services	9.6	3.1	5.7	8.1	4.9	4.4	4.0	3.7	3.6	3.4
Imports of goods and services	4.3	5.2	5.4	4.5	6.1	5.7	5.4	4.8	4.1	3.9
					(Contribution to real GDP growth, in percent)					
Domestic demand	-2.0	2.7	3.6	1.7	4.6	4.7	4.1	3.7	3.3	3.3
Private demand	-2.6	2.0	2.2	2.5	4.4	3.2	3.0	2.9	2.6	2.6
Public demand	0.6	0.7	1.4	-0.8	0.2	1.5	1.1	0.8	0.6	0.6
Final consumption	-1.5	1.8	3.1	2.6	3.7	3.4	3.2	3.0	2.6	2.6
Private consumption	-1.6	1.7	2.9	2.3	3.1	2.6	2.5	2.4	2.2	2.2
Public consumption	0.1	0.0	0.2	0.3	0.6	0.7	0.7	0.6	0.5	0.5
Investment	-0.5	0.9	0.5	-0.9	0.9	1.3	1.0	0.7	0.6	0.6
Gross fixed investment	0.1	0.7	0.6	-1.4	0.1	1.3	0.9	0.7	0.6	0.6
Private investment	-0.4	0.0	-0.6	-0.2	0.6	0.5	0.5	0.5	0.5	0.5
Public investment	0.5	0.7	1.2	-1.2	-0.4	0.8	0.5	0.2	0.2	0.2
Inventories	-0.5	0.2	-0.1	0.5	0.7	0.0	0.0	0.0	0.0	0.0
Net exports	2.8	-1.3	0.1	2.2	-0.8	-0.9	-1.0	-0.9	-0.5	-0.5
Exports of goods and services	5.5	1.9	3.6	5.2	3.2	3.0	2.7	2.5	2.5	2.4
Imports of goods and services	2.6	3.2	3.5	2.9	4.1	3.8	3.7	3.4	3.0	2.9

Sources: Bulgaria National Statistical Institute; and IMF staff estimates.

1/ Contributions to GDP growth.

Table 4. Bulgaria: Balance of Payments, 2013–22
(Millions of euros, unless noted otherwise)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Est.			Proj.		
Current account balance	536	35	-17	2,561	1,903	1,540	1,156	791	390	223
Trade balance	-2,933	-2,777	-2,622	-984	-1,192	-1,517	-1,712	-1,950	-2,127	-2,288
Exports (f.o.b.)	21,218	21,026	21,920	23,104	25,640	26,327	27,656	28,901	30,414	31,835
Imports (f.o.b.)	24,151	23,803	24,542	24,088	26,832	27,844	29,368	30,851	32,541	34,122
Services balance	2,653	2,514	3,004	3,092	3,147	3,126	3,162	3,154	3,172	3,178
Exports of non-factor services	5,888	6,738	6,967	7,591	8,066	8,145	8,428	8,661	8,957	9,221
Imports of non-factor services	3,235	4,224	3,963	4,498	4,919	5,019	5,267	5,507	5,785	6,043
Primary Income balance	-1,581	-1,319	-2,039	-1,131	-1,318	-1,486	-1,748	-1,892	-2,186	-2,318
Receipts	874	929	973	1,112	1,038	1,133	1,174	1,265	1,331	1,386
Payments	2,455	2,248	3,012	2,243	2,356	2,619	2,922	3,158	3,517	3,704
Secondary income balance	2,396	1,616	1,640	1,585	1,266	1,417	1,454	1,479	1,531	1,650
Capital account balance	469	960	1,422	1,070	587	905	1,062	1,204	1,313	1,456
Financial account balance	1,419	-2,090	-739	841	910	1,189	1,382	1,377	1,366	1,355
Foreign direct investment balance	-1,243	-882	-2,329	-340	-287	-369	-468	-571	-679	-793
Portfolio investment balance	132	-1,212	-582	-630	-388	-108	86	90	95	99
Other investment balance	2,424	22	2,156	1,827	1,602	1,682	1,781	1,875	1,967	2,065
Errors and omissions	-118	-1,277	1,586	676	0	0	0	0	0	0
Overall balance	-532	1,807	3,730	3,467	1,580	1,256	836	618	336	324
Financing	532	-1,807	-3,730	-3,467	-1,580	-1,256	-836	-618	-336	-324
Gross international reserves (increase: -)	532	-1,807	-3,730	-3,467	-1,580	-1,256	-836	-618	-336	-324
	(Percent of GDP, unless otherwise indicated)									
Memorandum items:										
Current account balance	1.3	0.1	0.0	5.3	3.8	2.9	2.1	1.3	0.6	0.3
Merchandise trade balance	-7.0	-6.5	-5.8	-2.0	-2.4	-2.8	-3.0	-3.3	-3.4	-3.5
Exports	50.5	49.2	48.4	48.0	50.7	49.2	49.1	48.9	49.0	48.9
Imports	57.5	55.7	54.2	50.0	53.1	52.0	52.1	52.2	52.4	52.4
Foreign direct investment balance	-3.0	-2.1	-5.1	-0.7	-0.6	-0.7	-0.8	-1.0	-1.1	-1.2
Terms of trade (merchandise, percent change)	-0.3	1.0	1.5	3.5	0.1	0.0	0.7	0.2	0.0	0.0
Exports of goods (volume, growth rate)	11.8	1.4	6.7	7.9	6.0	4.8	4.3	4.1	4.0	3.8
Imports of goods (volume, growth rate)	5.0	1.5	6.2	4.5	6.5	5.9	5.4	4.9	4.2	4.0
Exports of goods (prices, growth rate)	-3.6	-2.2	-2.3	-2.4	4.7	-2.0	0.7	0.3	1.2	0.8
Imports of goods (prices, growth rate)	-2.8	-2.9	-2.9	-6.0	4.6	-2.0	0.0	0.1	1.2	0.9
GDP (millions of euro)	42,011	42,762	45,286	48,128	50,550	53,514	56,331	59,125	62,057	65,134

Sources: Bulgarian authorities; and IMF staff estimates.

Table 5. Bulgaria: External Financial Assets and Liabilities, 2013–22

(Millions of euros, unless noted otherwise)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Est.			Proj.		
International investment position	-30,657	-32,184	-27,760	-22,675	-21,887	-19,425	-17,190	-15,178	-13,459	-11,764
Financial assets	31,265	36,111	38,816	46,238	49,663	54,772	59,682	64,586	69,420	74,465
Foreign direct investment	3,575	4,011	4,127	4,882	5,719	6,606	7,540	8,520	9,548	10,627
Portfolio investment	4,939	5,599	5,050	6,280	7,144	8,052	9,013	10,025	11,086	12,201
Other investments	8,326	9,966	9,353	11,178	13,138	15,196	17,375	19,669	22,077	24,603
Gross international reserves	14,426	16,534	20,285	23,899	23,662	24,918	25,754	26,373	26,709	27,033
Financial liabilities	61,923	68,295	66,576	68,913	71,550	74,197	76,872	79,764	82,879	86,228
Foreign direct investment	37,500	41,123	41,576	42,507	43,631	44,887	46,288	47,839	49,547	51,420
Portfolio investment	2,389	3,948	4,448	6,105	7,358	8,373	9,249	10,170	11,137	12,152
Other liabilities	22,023	23,149	20,476	20,203	20,561	20,937	21,336	21,755	22,195	22,657
(Percent of GDP, unless otherwise indicated)										
International investment position	-72.8	-75.2	-61.2	-47.0	-43.3	-36.3	-30.5	-25.7	-21.7	-18.1
Financial assets	74.4	84.4	85.7	96.1	98.2	102.4	105.9	109.2	111.9	114.3
Foreign direct investment	8.5	9.4	9.1	10.1	11.3	12.3	13.4	14.4	15.4	16.3
Portfolio investment	11.8	13.1	11.2	13.0	14.1	15.0	16.0	17.0	17.9	18.7
Other investments	19.8	23.3	20.7	23.2	26.0	28.4	30.8	33.3	35.6	37.8
Gross international reserves	34.3	38.7	44.8	49.7	46.8	46.6	45.7	44.6	43.0	41.5
Financial liabilities	147.4	159.7	147.0	143.2	141.5	138.7	136.5	134.9	133.6	132.4
Foreign direct investment	89.3	96.2	91.8	88.3	86.3	83.9	82.2	80.9	79.8	78.9
Portfolio investment	5.7	9.2	9.8	12.7	14.6	15.6	16.4	17.2	17.9	18.7
Other liabilities	52.4	54.1	45.2	42.0	40.7	39.1	37.9	36.8	35.8	34.8
Memorandum items:										
Gross external debt	87.9	92.0	73.6	70.7	63.0	61.3	58.9	56.5	55.9	53.2
Public 1/	8.1	14.1	12.3	14.1	11.2	10.8	10.3	9.7	10.8	10.4
Private	79.8	77.9	61.3	56.6	51.8	50.5	48.7	46.7	45.1	42.7
Short-term	22.8	21.0	16.3	15.4	14.0	14.1	13.8	13.7	13.9	13.5
Long-term	57.0	56.9	44.9	41.2	37.8	36.5	34.9	33.1	31.1	29.2
Net external debt 2/	53.6	53.3	28.8	21.1	16.2	14.7	13.2	11.9	12.9	11.7

Sources: BNB; NSI; and IMF staff estimates.

1/ General government, excluding publicly-guaranteed private debt.

2/ Gross debt minus gross international reserves.

Table 6a. Bulgaria: General Government Operations, 2013–22 1/

(Millions of leva, unless noted otherwise)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Est.			Proj.		
Revenue	27,735	28,145	30,964	32,671	33,658	36,489	38,375	40,284	42,376	44,560
Taxes	16,310	16,579	17,909	19,585	20,990	22,075	23,295	24,518	25,727	26,993
Taxes on profits	1,553	1,679	1,860	2,076	2,281	2,332	2,462	2,588	2,716	2,851
Taxes on income	2,348	2,596	2,731	2,961	3,209	3,418	3,616	3,798	3,984	4,180
Value-added taxes	7,366	7,264	7,740	8,553	9,219	9,771	10,339	10,913	11,449	12,010
Excises	4,056	4,039	4,525	4,805	5,032	5,231	5,485	5,757	6,043	6,342
Customs duties	146	149	159	173	182	192	203	213	223	234
Other taxes	840	851	893	1,017	1,068	1,130	1,190	1,249	1,311	1,376
Social contributions	4,818	5,187	5,699	6,029	6,725	7,203	7,619	8,006	8,398	8,809
Grants	2,656	2,922	3,648	2,907	1,513	2,368	2,784	2,852	3,100	3,350
Other revenue 2/	3,951	3,457	3,709	4,150	4,430	4,843	4,677	4,909	5,152	5,408
Expenditure	29,175	31,193	33,436	31,203	32,842	37,484	38,899	40,332	42,344	44,497
Expense	24,551	25,545	25,918	26,996	28,901	31,147	32,498	33,850	35,509	37,297
Compensation of employees 3/	4,560	5,622	5,644	5,777	6,145	6,486	6,821	7,141	7,513	7,925
Wages and salaries	4,454	4,553	4,616	4,847	5,146	5,644	5,972	6,291	6,620	6,987
Other compensation	106	1,069	1,028	929	999	843	848	850	893	938
Use of goods and services 4/	4,603	3,535	3,318	3,728	4,076	4,620	4,644	4,655	4,886	5,128
Interest	689	580	698	734	799	722	760	798	838	879
External	484	337	431	447	546	465	490	514	539	566
Domestic	204	243	267	288	253	257	271	284	298	313
Subsidies	1,307	1,452	1,634	1,645	1,945	2,146	2,259	2,371	2,489	2,612
Grants 5/	934	955	946	859	888	1,134	1,211	1,301	1,365	1,433
Social benefits	12,332	13,268	13,543	14,109	14,898	15,932	16,696	17,476	18,311	19,212
Pensions	7,762	8,136	8,433	8,734	9,097	9,494	9,949	10,419	10,903	11,437
Social assistance	2,160	2,317	2,424	2,543	2,701	2,777	2,808	2,827	2,968	3,115
Health Insurance Fund	2,410	2,815	2,687	2,832	3,101	3,662	3,938	4,230	4,440	4,660
Other expense	127	133	134	144	151	107	106	108	108	108
Contingency	644	1,186	767	401	431	205	223	232	262	274
Net acquisition of nonfinancial assets 6/	3,981	4,462	6,751	3,806	3,510	6,132	6,177	6,249	6,573	6,925
Net lending/borrowing	-1,441	-3,048	-2,472	1,468	816	-995	-524	-48	33	63
Primary balance	-752	-2,468	-1,774	2,202	1,615	-273	237	750	871	942
Financing	1440.7	3048.0	2471.9	-1468.1	-815.8	995.3	523.8	47.8	-33.0	-62.8
Privatization proceeds	15.6	18.0	4.2	6.2	13.7	11.0	43.9	2.1	0.0	0.0
Net external financing	-690.0	5784.3	1449.1	3518.6	-2156.1	177.7	28.3	-49.9	1898.0	146.5
Disbursements	1,119	6,091	6,438	3,876	39	522	303	293	2,170	2,830
Amortization	-1,809	-307	-4,988	-357	-2,195	-344	-275	-343	-272	-2,684
Net domestic financing	2151.1	-1279.2	-937.4	-557.9	1341.6	821.6	466.6	110.6	-1915.9	-194.3
Bank credit / Securities issuance	1,757	5,654	-19	4,812	790	2,065	1,386	1,123	-1,117	110
Amortization	-1,006	-3,497	-2,234	-1,051	-785	-1,243	-920	-1,013	-799	-304
Fiscal Reserve Account	1400.4	-3436.6	1316.0	-4319.2	1337.3	0.0	0.0	0.0	0.0	0.0
Net lending and other items	-37.6	-1587.0	1951.8	-4441.2	-15.0	-15.0	-15.0	-15.0	-15.0	-15.0
Memorandum items:										
Fiscal reserve account	4,681	8,117	6,801	11,120	9,783	9,783	9,783	9,783	9,783	9,783
Gross public debt	14,119	22,102	22,714	25,751	23,599	24,599	25,094	25,154	25,136	25,088
Nominal GDP (percent change)	0.2	1.8	5.9	6.3	5.0	5.9	5.3	5.0	5.0	5.0
Real GDP (percent change)	0.9	1.3	3.6	3.9	3.8	3.8	3.1	2.8	2.8	2.8
HICP inflation (percent change)	0.4	-1.6	-1.1	-1.3	1.2	2.0	2.1	2.1	2.1	2.1
Nominal private consumption (percent change)	-5.0	2.7	5.7	3.5	6.0	6.1	6.0	5.8	5.4	5.4
Nominal imports (percent change)	1.8	2.3	1.7	0.3	11.1	3.5	5.4	5.0	5.4	4.8

Sources: Ministry of Finance; and IMF staff estimates.

1/ On cash basis.

2/ Includes dividends. For 2018, includes concession revenue BGN 400 million for the Sofia Airport.

3/ Includes Other remuneration, which were previously integrated in use of goods and services, from 2014.

4/ From 2014, with the adoption of the Public Finance Act, other remunerations are re-classified to the compensation of employees.

5/ Contribution to EU budget.

6/ Includes only acquisitions of nonfinancial assets, i.e., capital expenditure. For 2018, includes concession revenue BGN 400 million for the Sofia Airport.

Table 6b. Bulgaria: General Government Operations, 2013–22 1/

(Percent of GDP, unless noted otherwise)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Est.			Proj.		
Revenue	33.8	33.7	35.0	34.7	34.0	34.9	34.8	34.8	34.9	35.0
Taxes	19.9	19.8	20.2	20.8	21.2	21.1	21.1	21.2	21.2	21.2
Taxes on profits	1.9	2.0	2.1	2.2	2.3	2.2	2.2	2.2	2.2	2.2
Taxes on income	2.9	3.1	3.1	3.1	3.2	3.3	3.3	3.3	3.3	3.3
Value-added taxes	9.0	8.7	8.7	9.1	9.3	9.3	9.4	9.4	9.4	9.4
Excises	4.9	4.8	5.1	5.1	5.1	5.0	5.0	5.0	5.0	5.0
Customs duties	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other taxes	1.0	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Social contributions	5.9	6.2	6.4	6.4	6.8	6.9	6.9	6.9	6.9	6.9
Grants	3.2	3.5	4.1	3.1	1.5	2.3	2.5	2.5	2.6	2.6
Other revenue 2/	4.8	4.1	4.2	4.4	4.5	4.6	4.2	4.2	4.2	4.2
Expenditure	35.5	37.3	37.8	33.1	33.2	35.8	35.3	34.9	34.9	34.9
Expense	29.9	30.5	29.3	28.7	29.2	29.8	29.5	29.3	29.3	29.3
Compensation of employees 3/	5.5	6.7	6.4	6.1	6.2	6.2	6.2	6.2	6.2	6.2
Wages and salaries	5.4	5.4	5.2	5.1	5.2	5.4	5.4	5.4	5.5	5.5
Other compensation	0.1	1.3	1.2	1.0	1.0	0.8	0.8	0.7	0.7	0.7
Use of goods and services 4/	5.6	4.2	3.7	4.0	4.1	4.4	4.2	4.0	4.0	4.0
Interest	0.8	0.7	0.8	0.8	0.8	0.7	0.7	0.7	0.7	0.7
External	0.6	0.4	0.5	0.5	0.6	0.4	0.4	0.4	0.4	0.4
Domestic	0.2	0.3	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Subsidies	1.6	1.7	1.8	1.7	2.0	2.1	2.1	2.1	2.1	2.1
Grants 5/	1.1	1.1	1.1	0.9	0.9	1.1	1.1	1.1	1.1	1.1
Social benefits	15.0	15.9	15.3	15.0	15.1	15.2	15.2	15.1	15.1	15.1
Pensions	9.4	9.7	9.5	9.3	9.2	9.1	9.0	9.0	9.0	9.0
Social assistance	2.6	2.8	2.7	2.7	2.7	2.7	2.5	2.4	2.4	2.4
Health Insurance Fund	2.9	3.4	3.0	3.0	3.1	3.5	3.6	3.7	3.7	3.7
Other expense	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Contingency	0.8	1.4	0.9	0.4	0.4	0.2	0.2	0.2	0.2	0.2
Net acquisition of nonfinancial assets 6/	4.8	5.3	7.6	4.0	3.5	5.9	5.6	5.4	5.4	5.4
Net lending/borrowing	-1.8	-3.6	-2.8	1.6	0.8	-1.0	-0.5	0.0	0.0	0.0
Primary balance	-0.9	-3.0	-2.0	2.3	1.6	-0.3	0.2	0.6	0.7	0.7
Financing	1.8	3.6	2.8	-1.6	-0.8	1.0	0.5	0.0	0.0	0.0
Privatization proceeds	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net external financing	-0.8	6.9	1.6	3.7	-2.2	0.2	0.0	0.0	1.6	0.1
Disbursements	1.4	7.3	7.3	4.1	0.0	0.5	0.3	0.3	1.8	2.2
Amortization	-2.2	-0.4	-5.6	-0.4	-2.2	-0.3	-0.2	-0.3	-0.2	-2.1
Net domestic financing	2.6	-1.5	-1.1	-0.6	1.4	0.8	0.4	0.1	-1.6	-0.2
Bank credit / Securities issuance	2.1	6.8	0.0	5.1	0.8	2.0	1.3	1.0	-0.9	0.1
Amortization	-1.2	-4.2	-2.5	-1.1	-0.8	-1.2	-0.8	-0.9	-0.7	-0.2
Fiscal Reserve Account	1.7	-4.1	1.5	-4.6	1.4	0.0	0.0	0.0	0.0	0.0
Net lending and other items	0.0	-1.9	2.2	-4.7	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:										
Gross public debt	17.2	26.4	25.6	27.4	23.9	23.5	22.8	21.8	20.7	19.7
Structural fiscal balance	-0.7	-2.3	-1.8	2.1	1.1	-1.0	-0.6	-0.1	0.0	0.0
Output gap (percent of potential GDP)	-2.8	-3.6	-2.5	-1.6	-0.8	0.1	0.3	0.2	0.1	0.0
Nominal GDP (millions of leva)	82,166	83,634	88,571	94,130	98,868	104,664	110,175	115,638	121,372	127,391

Sources: Ministry of Finance; and IMF staff estimates.

1/ On cash basis.

2/ Includes dividends. For 2018, includes concession revenue BGN 400 million for the Sofia Airport.

3/ Includes Other remuneration, which were previously integrated in use of goods and services, from 2014.

4/ From 2014, with the adoption of the Public Finance Act, other remunerations are re-classified to the compensation of employees.

5/ Contribution to EU budget.

6/ Includes only acquisitions of nonfinancial assets, i.e., capital expenditure. For 2018, includes concession revenue BGN 400 million for the Sofia Airport.

Table 7. Bulgaria: General Government Stock Position, 2008–2016

(Percent of GDP, unless noted otherwise)

	2008	2009	2010	2011	2012	2013	2014	2015	2016
Net financial worth	9.7	5.7	3.0	1.4	2.2	1.1	-4.0	-5.6	-5.8
Financial assets	30.6	29.4	26.8	24.2	27.2	26.4	31.5	27.5	32.5
Monetary gold and SDRs	…	…	…	…	…	…	…	…	…
Currency and deposits	14.0	12.3	9.8	8.1	11.0	9.6	11.1	8.5	13.9
Debt securities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Loans	1.8	1.7	1.5	1.3	1.2	1.1	2.1	1.5	2.1
Equity and investment funds shares	9.3	10.7	11.2	10.4	10.1	8.7	10.1	9.4	9.2
Insurance, pensions, and standardized guarantee schemes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives and employee stock options	…	…	…	…	…	…	…	…	…
Other accounts receivable	5.5	4.6	4.3	4.3	4.9	7.0	8.1	8.0	7.4
Liabilities	20.9	23.6	23.8	22.8	25.0	25.3	35.5	33.1	38.3
Special Drawing Rights (SDRs)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Currency and deposits	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt securities	8.3	8.6	9.7	9.5	12.0	11.2	17.4	20.3	23.9
Loans	4.8	5.7	6.2	6.1	5.8	6.7	10.6	6.6	6.9
Equity and investment funds shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Insurance, pensions, and standardized guarantee schemes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives and employee stock options	0.3	0.1	0.1	0.2	0.2	0.2	0.2	0.3	0.2
Other accounts receivable	7.6	9.3	7.8	7.1	6.9	7.2	7.3	5.9	7.4
Memorandum items									
Gross debt (at market value)	20.6	23.5	23.7	22.7	24.8	25.1	35.2	32.8	38.1
Gross debt (at face value)	20.6	23.0	23.1	22.3	24.5	25.2	34.1	32.2	
Gross debt (Maastricht definition)	13.0	13.7	15.3	15.2	17.5	17.9	27.0	26.0	
Nominal GDP (billions of leva)	72.8	73.0	74.8	80.8	82.0	82.2	83.6	88.6	94.1

Sources: Eurostat; and IMF staff calculations.

Table 8. Bulgaria: Monetary Accounts, 2013–22 1/

(Billions of leva, unless noted otherwise)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Est.			Proj.		
Monetary Survey										
Net foreign assets	28.4	35.0	40.7	49.7	51.7	47.7	50.4	53.2	56.3	59.8
Net domestic assets	55.8	50.5	51.7	49.7	53.8	58.0	62.4	67.3	68.3	70.1
Domestic credit	57.1	52.1	53.2	50.9	54.4	58.6	62.9	67.8	68.9	70.6
General government	1.2	0.4	2.4	-0.7	0.4	1.5	2.3	3.5	0.2	-2.7
Non-government	55.9	51.6	50.8	51.7	54.0	57.1	60.6	64.4	68.7	73.3
Broad money (M3)	67.2	68.0	74.0	79.6	85.7	92.5	99.3	106.3	113.7	121.7
Currency outside banks	9.1	10.2	11.4	12.8	14.1	15.5	16.6	17.7	18.9	20.3
Reserve money	17.3	19.2	27.5	28.6	29.6	31.5	33.4	35.4	37.4	39.6
Deposits 2/	58.2	57.8	62.6	66.8	71.6	77.0	82.7	88.6	94.8	101.4
Accounts of the Bulgarian National Bank										
Net foreign assets	26.8	30.8	38.1	44.9	44.7	45.0	45.1	51.8	52.4	59.6
Net foreign reserves (billions of euro)	13.7	15.7	19.5	23.0	22.9	23.0	23.1	26.5	26.8	30.5
Net domestic assets	-5.7	-7.3	-6.4	-11.8	-10.8	-10.0	-9.6	-9.6	-11.5	-11.8
Net claims on government	-4.3	-6.7	-6.0	-11.0	-10.1	-9.3	-8.8	-8.7	-10.6	-10.8
Base money	17.3	19.2	27.5	28.6	29.6	31.5	33.4	35.4	37.4	39.6
Currency in circulation	9.1	10.2	11.4	12.8	14.1	15.5	16.6	17.7	18.9	20.3
Banks reserves	8.2	9.1	16.1	15.8	15.4	16.0	16.8	17.7	18.5	19.3
Deposit money banks										
Net foreign assets	1.6	4.2	2.6	4.9	7.0	4.2	3.7	3.0	2.3	1.7
Gross foreign assets	13.6	15.3	10.6	12.4	14.5	15.6	15.1	14.4	13.7	13.1
Gross foreign liabilities	12.1	11.1	8.1	7.6	7.5	11.4	11.4	11.4	11.4	11.4
Net domestic assets	59.9	56.9	57.4	60.7	63.8	67.2	71.1	75.9	78.9	80.8
Domestic credit	61.3	58.6	59.1	61.9	64.4	67.8	71.6	76.4	79.4	81.3
Memorandum items:			(Annual percentage change, unless otherwise indicated)							
Base money	-0.4	11.1	43.0	4.0	3.5	6.5	5.9	5.9	5.8	5.8
Broad money	8.9	1.1	8.8	7.6	7.7	7.9	7.4	7.0	7.0	7.0
Domestic non-government credit	0.3	-7.7	-1.6	1.8	4.6	5.8	6.1	6.2	6.7	6.7
Domestic deposits	9.3	-0.6	8.2	6.8	7.1	7.6	7.4	7.1	7.0	7.0
Domestic currency	8.6	0.1	9.2	10.1	10.8	8.0	7.7	7.4	7.3	7.3
Foreign currency	10.3	-1.5	6.8	1.9	1.3	7.0	6.9	6.5	6.5	6.5
Money multiplier (ratio)	3.9	3.5	2.7	2.8	2.9	2.9	3.0	3.0	3.0	3.1
Velocity (M3) (ratio)	1.2	1.2	1.2	1.2	1.2	1.1	1.1	1.1	1.1	1.0
GDP (millions of leva)	82,166	83,634	88,571	94,130	98,868	104,664	110,175	115,638	121,372	127,391

Sources: Bulgarian National Bank, National Statistics Institute, and Fund staff estimates and projections.

1/ Due to the revocation of the banking license of KTB, the bank is excluded as a reporting agent from the monetary statistics data starting in November 2014.

2/ Includes deposits at central bank.

Table 9. Bulgaria: Financial Soundness Indicators, 2010–17

(Percent)

	2010	2011	2012	2013	2014	2015	2016	2017Q2
Core indicators								
Capital adequacy								
Capital to risk-weighted assets	17.4	17.6	16.6	17.0	21.9	22.2	22.2	22.5
Tier 1 capital to risk-weighted assets	15.2	15.7	15.1	16.0	20.0	20.5	20.9	21.3
Asset quality								
Nonperforming loans to total gross loans	11.9	15.0	16.6	16.9	16.7	14.6	13.2	12.4
Nonperforming loans net of provisions to capital	28.0	36.9	38.9	36.2	43.5	49.8	44.7	40.5
Large exposures to capital	90.6	111.6	115.1	119.7	64.3	51.4	58.2	56.4
Earnings and profitability								
Return on assets	0.8	0.6	0.7	0.6	0.8	1.1	1.4	1.5
Return on equity 1/	7.8	5.7	6.3	5.7	7.2	7.9	10.4	11.1
Net interest income to gross income	74.1	73.2	68.8	68.5	67.4	66.2	69.2	72.8
Noninterest expense to gross income	49.1	50.6	52.1	54.0	49.9	47.3	44.0	47.3
Personnel expense to total income	17.8	18.5	19.1	19.8	18.5	17.2	18.4	21.1
Liquidity								
Liquid assets to total assets	20.9	22.0	22.4	23.4	26.1	31.1	32.4	31.2
Liquid assets to short-term liabilities	30.0	29.1	30.0	30.6	33.7	40.2	41.0	39.5
Liquid assets to total liabilities	24.2	25.4	25.7	26.9	29.9	39.2	40.3	39.1
Encouraged indicators								
Deposit-taking institutions								
Capital to assets 2/	10.5	10.8	10.1	10.4	11.6	12.0	11.6	12.1
Trading income to total income	5.4	5.0	7.4	5.8	7.0	7.9	10.3	-0.1
Personnel expenses to noninterest expenses	36.4	36.5	36.7	36.7	37.1	36.3	41.7	44.5
Customer deposits to total (non-interbank) loans	87.8	95.4	100.2	107.4	115.5	127.7	134.7	132.7
Foreign currency denominated loans to total loans	61.3	63.7	64.0	61.2	57.0	50.0	45.1	41.8
Foreign currency denominated liabilities to total liabilities	58.6	54.8	51.8	50.2	49.0	42.6	41.7	40.5

Source: Bulgarian National Bank.

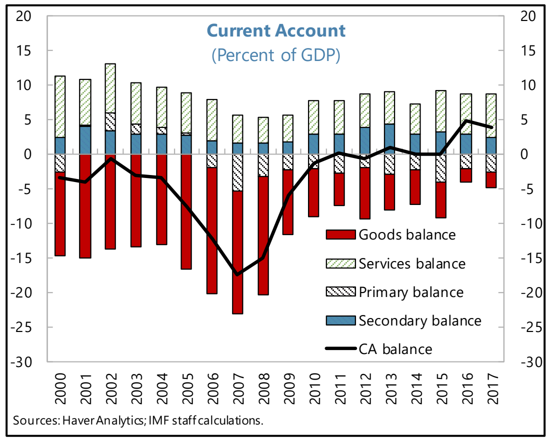
1/ Return on equity is calculated with Tier I capital as denominator.

2/ Capital to assets is based on Tier I capital.

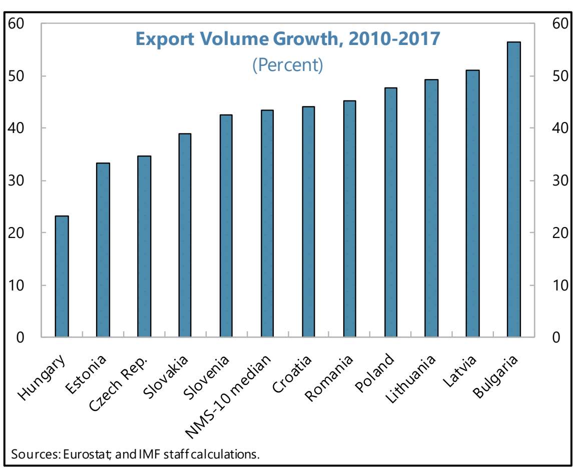
Annex I. Competitiveness and External Sector Assessment

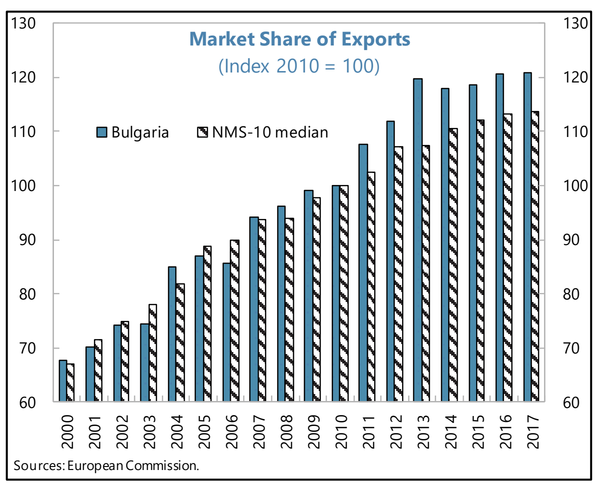
Staff's overall assessment is that Bulgaria's external position in 2017 was moderately stronger than implied by fundamentals and desirable policies. Nonetheless, the continued labor shortage and labor cost increases in excess of productivity growth could weaken competitiveness going forward.

1. The current account has corrected sharply since the financial crisis and posted large surpluses in 2016 and 2017. After reaching a deficit of about 24 percent of GDP in 2007, the current account adjusted rapidly. The correction was precipitated by the collapse of external financing and manifested in moderate import growth coupled with strong export growth. While the current account was broadly balanced during 2011–15, it recorded a surplus of 5.3 percent in 2016, and is estimated to have recorded a surplus of 3.8 percent of GDP in 2017.



2. Bulgaria's export performance has been strong since 2010 but the market share expansion slowed down in recent years Bulgaria's goods export volume is estimated to have grown by about 75 percent between 2010 and 2017, exceeding export growth of other EU new member states. Over the same period, services volume is estimated to have grown by about 24 percent. The world market share of Bulgarian exports of goods and services increased steadily to rise above the NMS median. However, the market share has stayed broadly constant since 2013 unlike regional peers, probably reflecting a sharp appreciation in the ULC-based real exchange rate around the same year.





Current Account

3. **The CA model of the EBA-lite framework adjusted for Bulgaria specific-factors points to a moderately stronger current account than fundamentals and desirable policies.** While the unadjusted model points to a sizable undervaluation (18.7 percent) with an estimated CA gap of 8.4 percent of GDP, it does not capture country-specific factors underpinning Bulgaria's CA developments. Specifically, in staff's view, the CA is boosted by temporary factors, notably a drop in public investment and stronger exports growth largely owing to the recent buoyancy of tourism driven by political uncertainties in some traditional tourism destinations. Owing to these reasons, staff estimates the cyclically adjusted CA, removing all temporary factors, to be about 0.8 percent of GDP. The estimated current account norm is -4.6 percent of GDP. However, based on historical experience and in staff's judgement, external financing a deficit of that size may not be sustainable. Staff assesses that a smaller CA deficit of about 2½ percent of GDP is a more appropriate norm. The CA gap is estimated at 3.5 percent of GDP after the adjustments, and the REER would be undervalued by 7.8 percent.

EBA-Lite CA Approach Results, 2017
(percent of GDP)

Standard version		*Adjusted CA norm*	
Actual CA	3.8	Actual CA	3.8
Cyclically-adjusted CA	3.7	Cyclically-adjusted CA (removing all temporary factors)	0.8
CA norm	-4.6	Adjusted CA norm	-2.6
CA gap	8.4	CA gap	3.5
o/w policy gap	1.3	o/w policy gap	1.3
Elasticity	-0.5	Elasticity	-0.5
REER gap	-18.7	REER gap	-7.8

Exchange Rate Indicators

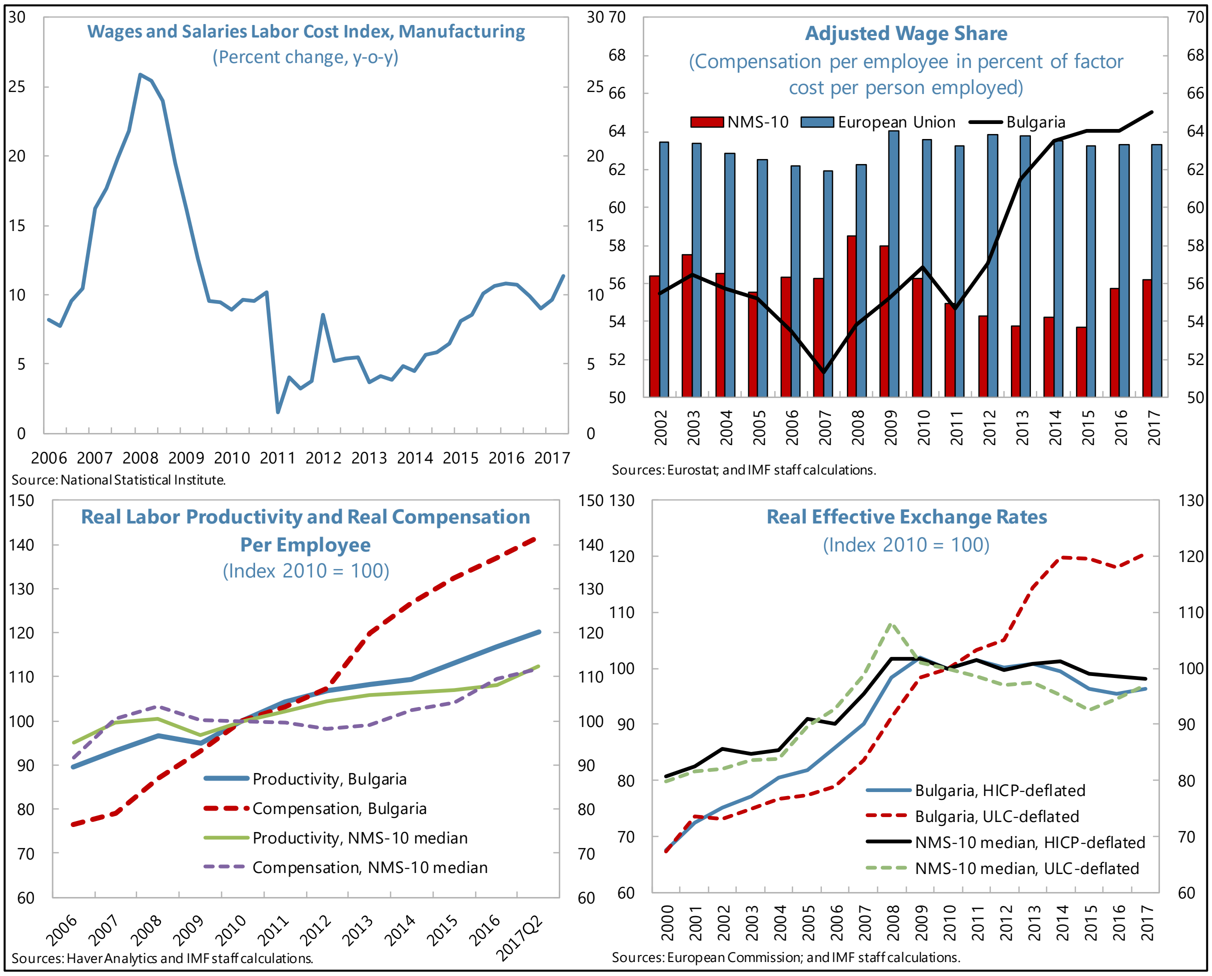
4. **Rapid wage growth poses risks to external competitiveness**. In Bulgaria, labor costs have outpaced productivity growth since 2012, while in regional peer countries, wage growth developed more in line with productivity. Manufacturing labor costs hit the bottom in 2011 and have since been on an upward trend. Bulgaria's adjusted wage share in total factor cost decoupled from regional peers in 2011, reached the EU level in 2014, and has since slightly surpassed that level. At present, increasing wages do not appear to have seriously impaired Bulgaria's export performance as labor cost remains at comparatively low levels. However, its market share growth has broadly stalled since 2013, and going forward, export competitiveness could weaken should the current trend of divergence between wage growth and productivity growth continue.

5. **Bulgaria's real effective exchange rates developments suggests that its real exchange rates are broadly in line with or somewhat weaker than fundamentals.** Bulgaria's REER based on ULC has strongly appreciated well beyond the financial crisis level on the back of rising labor costs, while the consumption-based REER, was broadly stable during the post-crisis low-inflation environment and has depreciated recently in view of imported deflation—which lasted up to 2016—largely owing to falling metal and textile product prices. Per the REER model of the extended External Balance Assessment ("EBA-lite"), the CPI-based REER is estimated to be above the REER norm by 1.2 percent, suggesting a slight overvaluation. A comparable analysis of ULC-based REER would likely indicate a larger overvaluation, judging from the divergence of Bulgaria's ULC-based REER from regional peers. While a formal assessment of ULC-based REER is not available, a comparison with the crisis period indicates as much. The ULC-based REER

EBA-Lite REER Approach
(percent of GDP)

REER gap	1.2

appreciated by 44 percent between 2007 and 2017 while CPI-based REER appreciated by 7 percent over the same period.



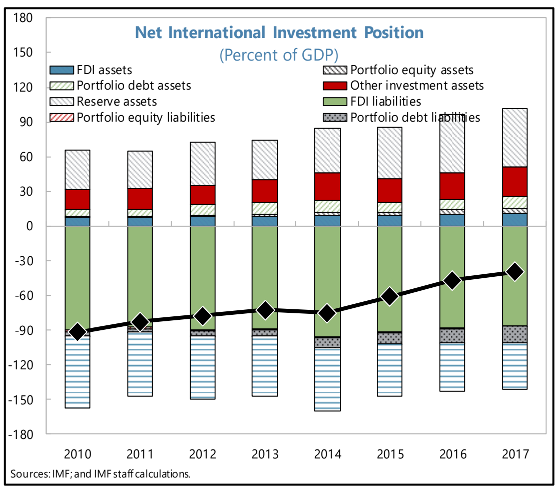
6. Considering current account and exchange rate indicators, staff assesses the external position of Bulgaria to be moderately stronger than fundamentals and desirable policy settings, albeit subject to substantial statistical and model uncertainty. The adjusted current account model—which better captures the Bulgaria specificities—point to a real exchange rate gap of -7.8 percent. The CPI-based real effective exchange rate model yields an REER gap of 1.2 percent. In addition, the ULC-based REER has appreciated by about 20 percent since 2011, while the CPI-based REER remains broadly stable. The range of the estimated REER gaps reflects the unusually high uncertainties. Besides the abovementioned factors, there is potential for large revisions to the 2016 and 2017 CA estimates, judging by past experience,[1] and reflecting Bulgaria's large volatility in

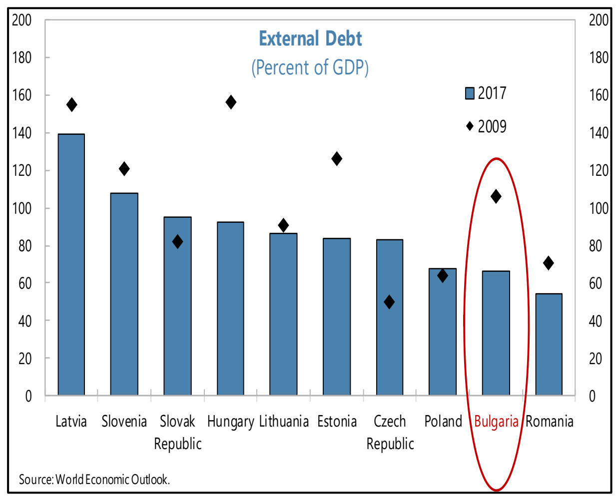
[1] For example, 2015 CA estimate has been revised from 1.4 percent of GDP to 0. The 2016 CA estimate will be revised in March 2018, and the 2017 estimate will be revised in September 2018 for the trade data and in March 2019 for FDI data. Moreover, the BNB has discontinued the international transactions reporting system (ITRS), which provides timely, comprehensive data for compiling items in the services and income accounts. The non-availability of data from the ITRS is likely to undermine the timeliness, accuracy, and reliability of the estimates until adequate data sources are developed.

the balance of payments with a CA standard deviation of 8 percent. Bulgaria also has the need to rapidly reduce external debt (paragraph 8).

Foreign Asset and Liability Position

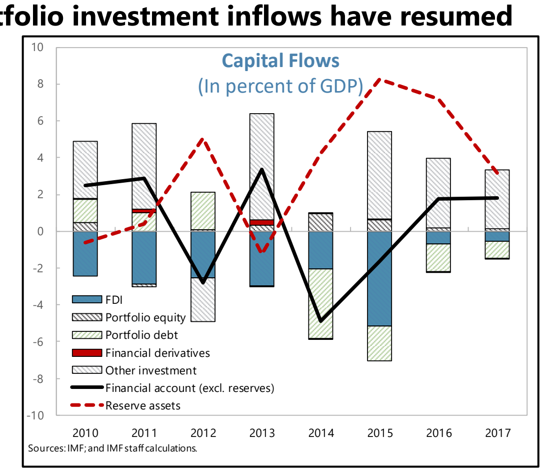
7. Bulgaria's international investment position has improved in recent years, but the country could benefit from further external debt decline. The IIP increased from about 92 percent of GDP net liabilities in 2010 to 47 percent of GDP net liabilities in 2016 and estimated to improve further to about 40 percent in 2017. The improvement has mainly been driven by an increase in reserve assets and a reduction in other liabilities, the latter reflecting private-sector deleveraging, in particular by banks. External debt has been declining in recent years, from 106 percent of GDP in 2009 to about 66 percent in 2017.[2] While the IIP position is not vulnerable, a further reduction in the external debt possibly at a faster pace would strengthen the country's external position and bring the external debt within the range of 35–40 percent of GDP beyond which the country is considered vulnerable to external shocks.[3]





Capital and Financial Account Flows

8. Direct investment has increased and net portfolio investment inflows have resumed recently. Net FDI inflows have been stable at around an average of 2½ percent of GDP over 2010–14 and increased to 5.1 percent of GDP in 2015. However, net FDI inflows slowed down in 2016 to 0.7 percent of GDP and are estimated at 0.6 percent in 2017. Portfolio debt inflows have resumed in 2014, reflecting renewed investor confidence in Bulgaria, although their pace has moderated over 2015–17. Private-sector bank-led deleveraging is ongoing, as other investment positions abroad have been reduced. Reserve accumulation has



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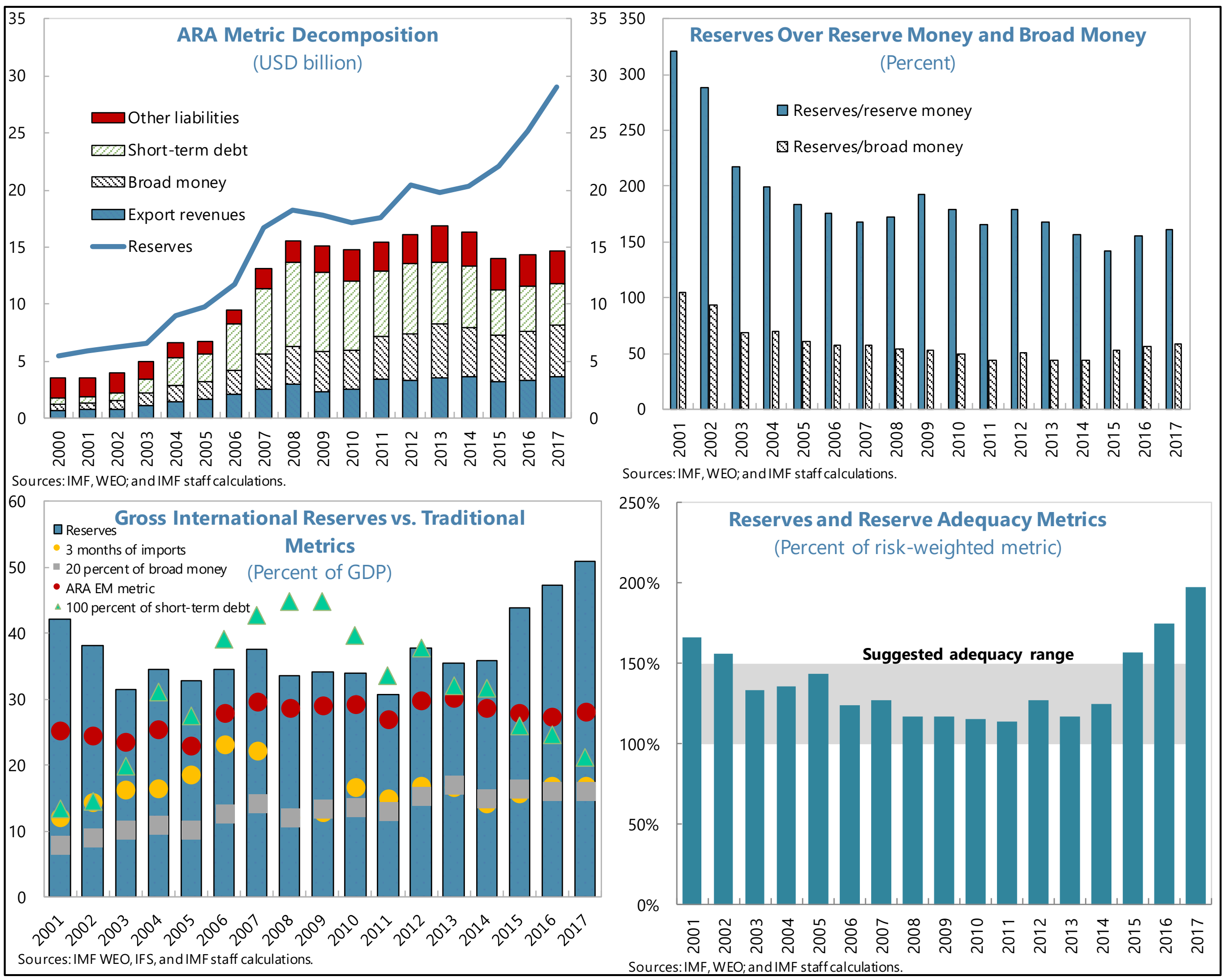
[2] Excluding inter-company lending, external debt declined to about 38 percent in 2017

[3] World Economic Outlook, 2003 September

picked up (with some signs of stabilization in 2016) mainly on the back of current and capital account surpluses.

9. Bulgaria's international reserves are estimated to be adequate to support the CBA. Reserves stood at 47 percent of GDP at end-2017, well above the standard rules of thumb (three months' coverage of prospective imports and 20 percent of broad money). Bulgaria's reserves exceeded 100 percent of short-term debt, and are estimated at 198 percent of the standard IMF metric in 2017, well above the 100–150 percent range considered appropriate. The standard metric, however, needs to be interpreted with caution, as the ratio of reserves over CBA liabilities stood at 114 percent at end-2017, while 100 percent coverage is required under the CBA.



Annex II. Risk Assessment Matrix[1]

Source of Risk	Relative Likelihood	Impact if Realized
1. High wage growth (medium term).	**High** Negative impact through undermining competitiveness.	**High/Medium** Higher consumption growth. Competitiveness and the current account weaken. Possible boom-bust cycle.
2. Weak progress in structural reforms to raise productivity and mitigate the impact of aging and emigration (short/medium term).	**High/Medium** Lack of political support delays the structural reform agenda, including reforms that would reduce medium-term fiscal risks.	**High** Lower potential growth, high structural Unemployment, and increased fiscal risks.
3. Inadequate actions to address weaknesses in the banking system, as identified by the AQR/stress test and the FSAP (short term).	**Medium** Banks identified by AQR/stress test are unable to raise high quality private capital and/or inadequate progress in implementing a comprehensive supervisory strategy for them.	**High/Medium** Increased vulnerability to unanticipated shocks. Financial sector stability weakened.
4. Structurally weak growth in the Euro area (medium term).	**High/Medium** Bulgaria's exports are highly dependent on Euro-area markets. There would be direct negative influence through trade and investment channels.	**High** Low potential growth, high structural unemployment and low FDI, continued fiscal pressures.
5. Significant slowdown in large EMs (short/medium term).	**Medium** Negative impact through trade and investment channels.	**Medium** Lower exports, employment, and growth
6. Policy and geopolitical uncertainties, including uncertainty associated with negotiating post-Brexit arrangements (short/medium term).	**High** Increased investor uncertainty. Negative impact through trade channel.	**High/Medium** Exacerbating low investment. Lower exports, employment, and growth.
7. Tighter global financial conditions (Fed normalization and tapering by ECB) (short term)	**High** Negative impact through increase in funding costs for banks, corporates, and households.	**Medium** Lower investment and growth.
8. European bank distress (short term)	**Medium** Foreign bank subsidies are primarily funded by local deposits, with limited funding from parent banks.	**Medium/Low** Lower bank lending and growth.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relatively likelihoods of risks listed is the staff's subjective assessment of the risks surrounding the baseline. The RAM reflects staff's views on the sources of risk and overall level of concern as of the time of discussions with the authorities.

Annex III. Debt Sustainability

Bulgaria debt outlook has improved. External debt is steadily declining and public debt is sustainable within the medium-term projection horizon. Under the baseline scenario, public debt will fall from around 27 percent of GDP at end-2016 to 20 percent of GDP by end-2022, which is low by international standards. Standardized macro-fiscal stress tests indicate that lower growth and a combined macro-fiscal shock could shift the debt-to-GDP ratio upwards, but debt would remain on a downward trajectory.

External Debt

1. The external debt's downward trend continues and is accelerating. After reaching a peak of 106.4 percent of GDP at end-2009, gross external debt has been steadily declining since then and stood at about 66 percent at end-2016, mainly on account of private sector deleveraging in the banking sector. Since 2014 declining inter-company lending has also been contributing to the downward trend. Excluding inter-company lending, external debt declined to about 38 percent by end-2017, largely covered by international reserves. Rollover risks related to external exposure in the non-bank private sector are contained given moderate short-term exposure; these risks also did not materialize during the global financial crisis. External debt could be brought down faster to further reduce the country's external vulnerabilities.[1]

2. Under staff's baseline projection scenario, gross external debt is expected to decline further over the medium term. External debt is set to decline to around 53 percent of GDP by 2022. The medium-term decline in gross external debt is largely driven by nominal GDP growth whereas nominal external debt is expected to remain broadly stable as the authorities issued no external debt in 2017, the pace of private sector deleveraging moderates and phases out while the authorities have no plan for new external borrowing in 2018-2020. The historical scenario, projecting external debt on the basis of 10-year averages of key determinants, generates a very similar trajectory.

3. External debt dynamics appear broadly resilient to shocks. Shocks to the interest rate, the growth rate, and the current account deficit would shift the trajectory of external debt relative to GDP upwards. The external debt to GDP ratio is projected to eventually resume its downward-sloping path over the medium-term under each of these scenarios except for the current account shock where external debt is projected to reach 76 percent over the medium-term.

Public Debt

4. General government gross debt increased temporarily in 2016, but is projected to decline over the medium term. Under the IMF's standard DSA methodology, Bulgaria is considered a "lower scrutiny" country given its relatively moderate level of debt and gross financing needs. In 2016, public debt rose to 27.4 percent of GDP due to the sizable Eurobonds issuance (EUR

[1] Beyond the range of 35−40 percent of GDP, external debt is found to start having a negative impact of growth (World Economic Outlook, 2003 September).

2 billion or 4.6 percent of GDP). However, in 2017, mainly due to the repayment of the Eurobonds, it is estimated to decline by 3.5 percentage points of GDP. The authorities issued no new external bonds in 2017 and have no plan to do so in 2018. In the medium term, the authorities plan to achieve the balanced budget in 2020. Fiscal consolidation and a favorable growth-interest rate differential will help reduce general government debt over the medium term.

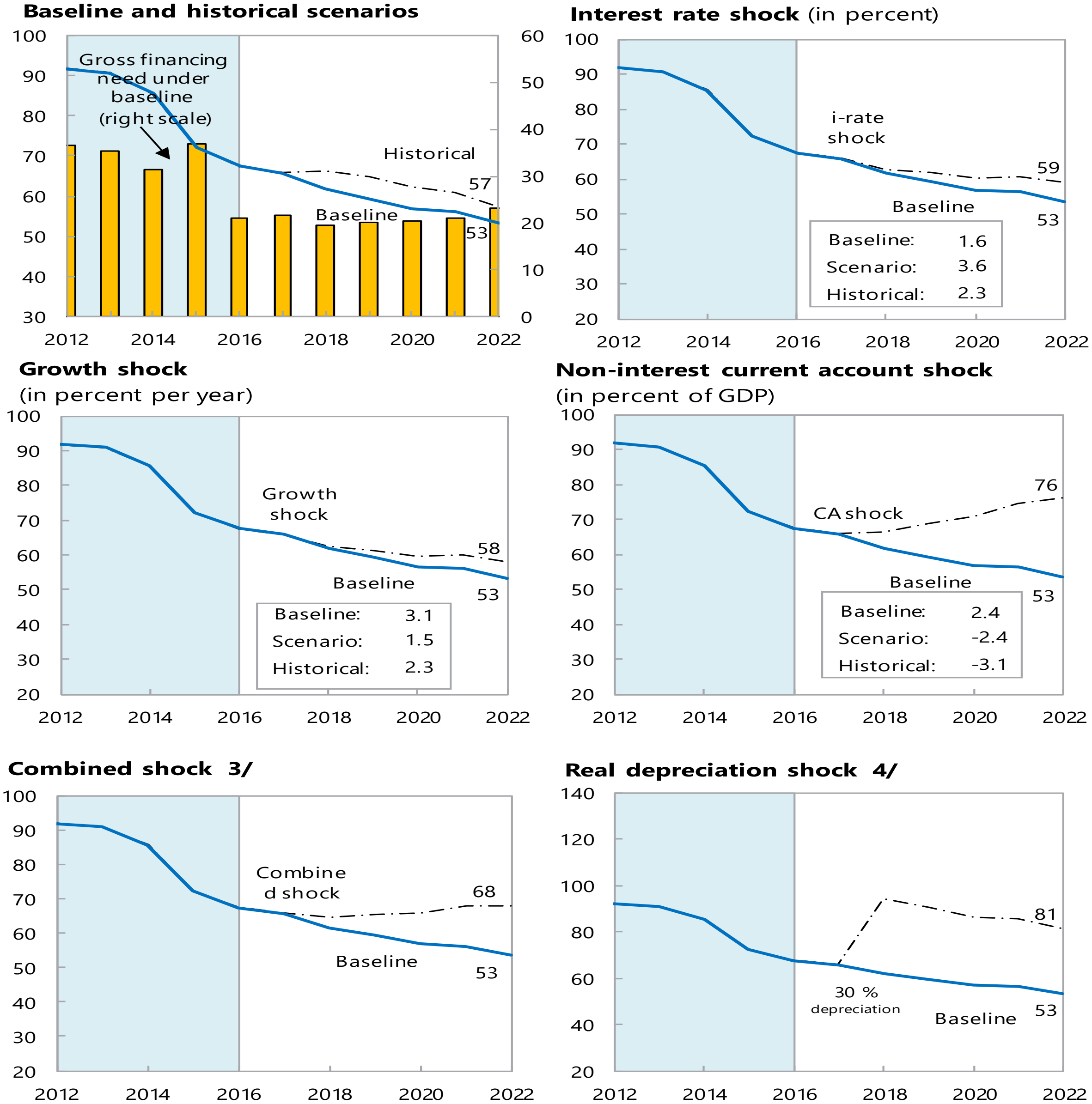
5. Public debt remains at manageable levels. In the baseline projections, assuming Fiscal Reserve Account (FRA) balances remain unchanged from the projected 2017 level (BGN 8.9 billion, 9.1 percent of GDP) for 2017-2022, the general government debt is projected to decline to 19.7 percent of GDP, which is low by international standards.[2] If the government were to draw down FRA for financing, the pace of debt reduction could be faster.[3] Alternative scenarios indicate that public debt would likely remain below 30 percent of GDP under various shock scenarios. Gross financing needs are also projected to remain well below 6 percent of GDP under shocks.

[2] The minimum requirement of FRA is set with the annual budget law. For 2017, it is set at BGN 4.5 billion.

[3] There have been years when the deficit has been at least partially financed out of the fiscal reserve, but recently such practices are avoided.

Figure 1. Bulgaria: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks, except in case of the interest rate shock where a 200 bp shock is assumed. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2018.

Figure 2. Bulgaria: Public Sector Debt Sustainability Analysis (DSA) – Baseline Scenario

(in percent of GDP, unless otherwise indicated)

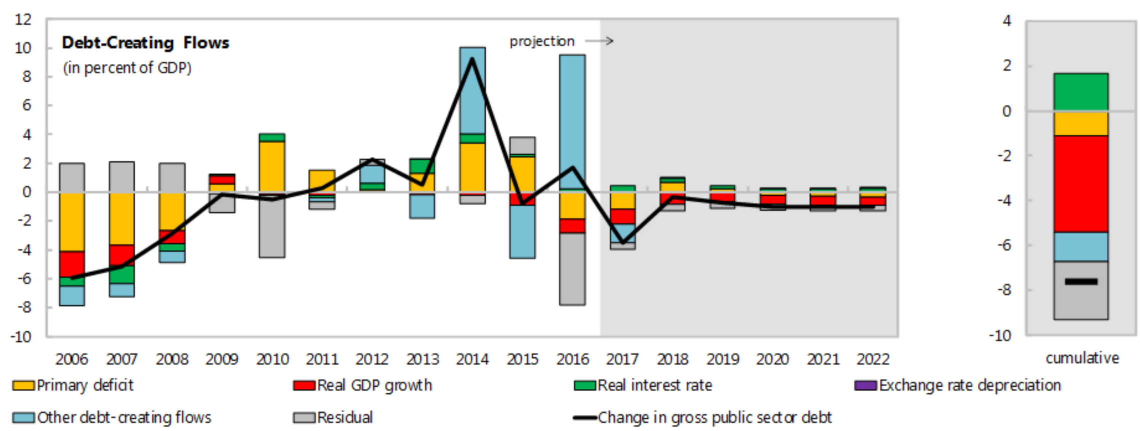
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022
Nominal gross public debt	17.6	25.6	27.4	23.9	23.5	22.8	21.8	20.8	19.7
Public gross financing needs	2.8	10.9	-0.1	2.2	2.5	1.6	1.2	0.9	2.3
Real GDP growth (in percent)	2.5	3.6	3.9	3.8	3.8	3.1	2.8	2.8	2.8
Inflation (GDP deflator, in percent)	4.3	2.2	2.2	1.2	1.9	2.1	2.1	2.1	2.1
Nominal GDP growth (in percent)	6.9	5.9	6.3	5.0	5.8	5.2	5.0	5.0	5.0
Effective interest rate (in percent) [4/]	4.9	3.2	3.2	3.1	3.1	3.1	3.2	3.3	3.5

As of December 18, 2017		
Sovereign Spreads		
EMBIG (bp) 3/		103
5Y CDS (bp)		98
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB-	BBB-
Fitch	BBB	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.3	-0.8	1.7	-3.5	-0.3	-0.7	-1.0	-1.0	-1.0	-7.6	-0.3
Identified debt-creating flows	-0.2	-2.0	6.7	-3.0	0.1	-0.3	-0.6	-0.6	-0.6	-5.1	
Primary deficit	0.0	2.4	-1.9	-1.2	0.7	0.2	-0.2	-0.3	-0.3	-1.1	
Primary (noninterest) revenue and grants	33.1	34.5	34.2	33.6	34.4	34.4	34.4	34.5	34.6	206.0	
Primary (noninterest) expenditure	33.1	37.0	32.4	32.4	35.2	34.6	34.2	34.2	34.3	204.9	
Automatic debt dynamics [5/]	-0.5	-0.7	-0.7	-0.5	-0.6	-0.5	-0.4	-0.3	-0.3	-2.6	
Interest rate/growth differential [6/]	-0.5	-0.7	-0.7	-0.5	-0.6	-0.5	-0.4	-0.3	-0.3	-2.6	
Of which: real interest rate	0.0	0.2	0.2	0.5	0.2	0.2	0.2	0.2	0.3	1.7	
Of which: real GDP growth	-0.5	-0.9	-1.0	-1.0	-0.9	-0.7	-0.6	-0.6	-0.6	-4.3	
Exchange rate depreciation [7/]	0.0	0.0	0.0	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.2	-3.7	9.3	-1.3	0.0	0.0	0.0	0.0	0.0	-1.3	
Please specify (1) (e.g., drawdown of deposits) (negative)	-0.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	0.6	-3.7	9.3	-1.3	0.0	0.0	0.0	0.0	0.0	-1.3	
Residual, including asset changes [8/]	0.0	1.2	-5.0	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-2.6	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

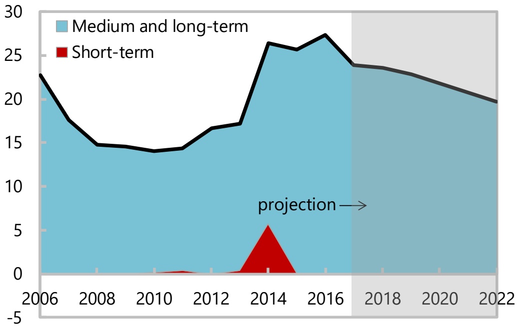
8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

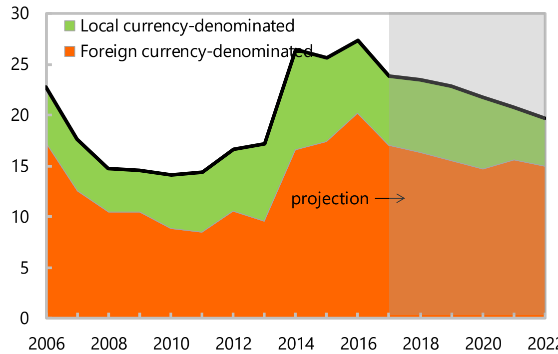
Figure 3. Bulgaria: Public DSA – Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(in percent of GDP)



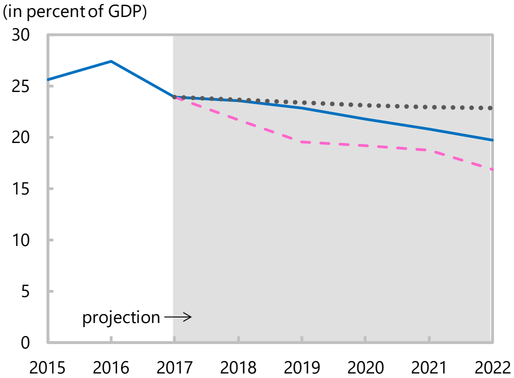
By Currency
(in percent of GDP)



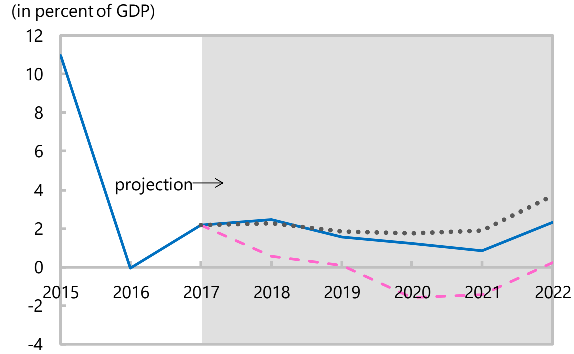
Alternative Scenarios

Baseline Historical Constant Primary Balance

Gross Nominal Public Debt
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



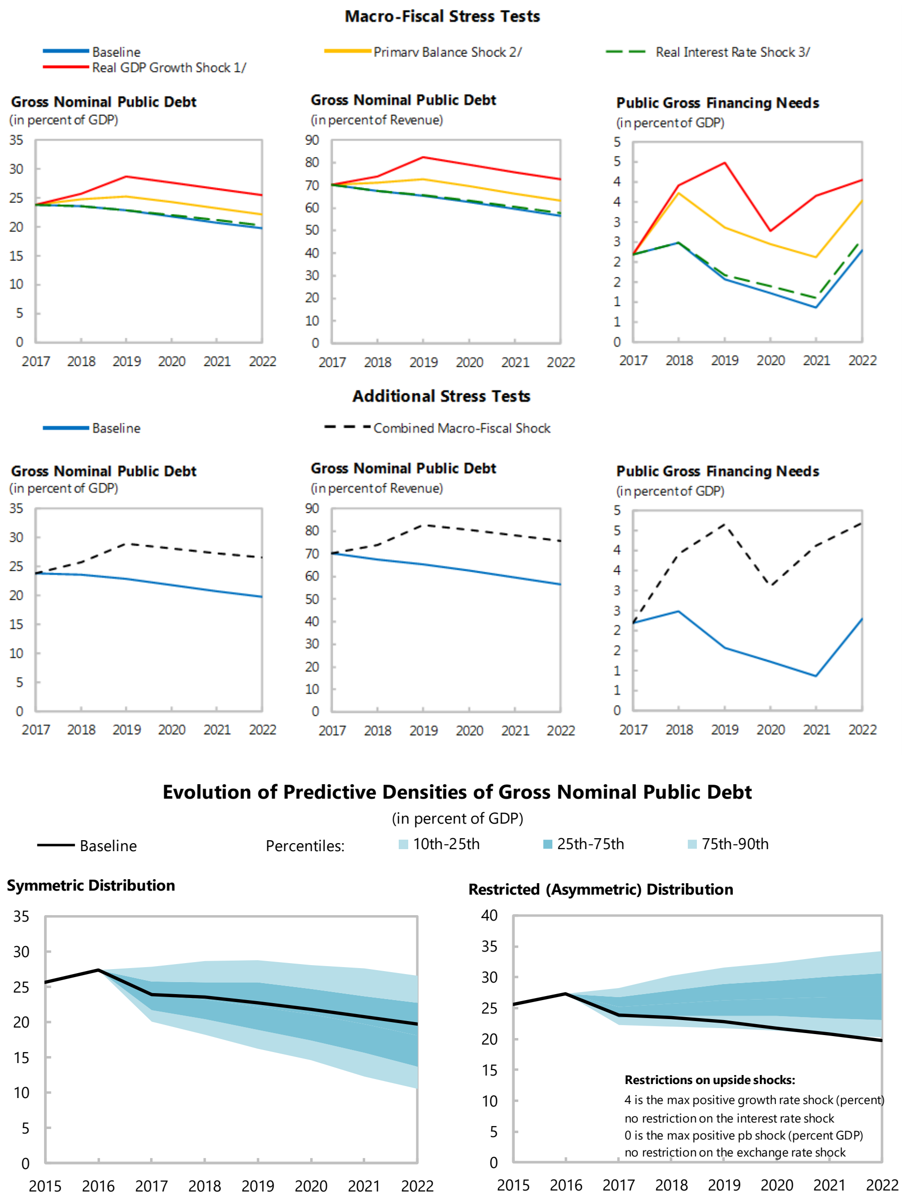
Underlying Assumptions
(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	3.8	3.8	3.1	2.8	2.8	2.8
Inflation	1.2	1.9	2.1	2.1	2.1	2.1
Primary Balance	1.2	-0.7	-0.2	0.2	0.3	0.3
Effective interest rate	3.1	3.1	3.1	3.2	3.3	3.5
Constant Primary Balance Scenario						
Real GDP growth	3.8	3.8	3.1	2.8	2.8	2.8
Inflation	1.2	1.9	2.1	2.1	2.1	2.1
Primary Balance	1.2	1.2	1.2	1.2	1.2	1.2
Effective interest rate	3.1	3.1	3.1	3.2	3.3	3.3

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	3.8	2.3	2.3	2.3	2.3	2.3
Inflation	1.2	1.9	2.1	2.1	2.1	2.1
Primary Balance	1.2	-0.5	-0.5	-0.5	-0.5	-0.5
Effective interest rate	3.1	3.1	3.1	3.1	3.3	3.6

Source: IMF staff.

Figure 4. Bulgaria: Public DSA – Stress Tests



Source: IMF staff.

1/ Real GDP growth shock scenario assumes (i) real GDP growth for 2018-19 to be below the baseline projections by a 10-year historical standard deviation; (ii) the primary balance deteriorates; (iii) additional borrowing leads to increases in interest rate of 25 bbp per 1 percent of GDP worsening of the primary balance; and (iv) inflation declines by 0.25 percentage point per 1 percentage point decrease in GDP growth.
2/ Primary balance shock scenario assumes (i) the primary balance for 2018-19 to be below the baseline projections by 50 percent of the 10-year historical standard deviation; and (ii) additional borrowing leads to increase in interest rate of 25 bbp per 1 percent of GDP worsening of the primary balance.
3/ Real interest rate shock scenario assumes nominal interest rate increases by the difference between the maximum real interest rate over history (last 10 years) and the average real interest rate level over projection.

Appendix I. Main Recommendations of the 2016 Article IV Consultation and Authorities' Actions

IMF 2016 Article IV Recommendations	Policy Actions
Financial Sector Policies	
Follow-up on the recently completed AQR and stress test to restore capital buffers of identified banks.	The three identified banks have raised capital, but two of them would still require larger capital buffers.
Use the information acquired during the banking assessment to pursue a more risk-based supervisory review and evaluation process, and devote adequate resources to more inspections.	The BNB has issued a draft risk assessment manual. It is developing a multi-year action plan with detailed activities to continue strengthening banking supervision.
Improve bank governance by strengthening the regulatory requirements for transparency of groups' operational and ownership structures and upgrading the Boards' governance.	Amendments to the LCI strengthened the definition and tightened the control of related-party exposures in line with EU legislation and country-specific circumstances.
Take proactive measures to promote effective write-offs within a reasonable time frame to reduce NPLs.	NPLs have declined from 16.9 percent of total loans in 2013 to 11.4 percent in 2017Q3, but are still well above the EU average. Draft guidance by the BNB's supervision department incorporates relevant supervisory metrics for credit loss provisioning, NPL accounting write-offs, and collateral valuation.
Fiscal Policy	
Save the revenue overperformance in 2016 to strengthen fiscal buffers.	The fiscal balance (1.6 percent of GDP) substantially exceeded the original budget target.
Improve public spending efficiency, particularly in the areas of education, health, and public investment.	The authorities are undertaking selective public spending reviews in cooperation with the World Bank. Efforts to improve public goods including public infrastructure, education, and healthcare are continuing.
Need further pension reforms to address long-term spending pressures.	No reform of pension system is planned at this stage.
Structural Reforms	
Labor market	
Make active labor market policies more effective by better targeting training and education to reduce skill mismatch and improve institutional environment and career opportunities for reintegration.	The authorities have implemented multiple measures to address skill mismatches including the pilot programs to improve vocational training in partnership with the business community.
SOEs	
Enhance the governance and performance of state-owned enterprises to reduce contingent liabilities and improve productivity. Monitor fiscal contingent liabilities closely and reflect in fiscal planning.	The authorities received a technical assistance on oversight and management of SOEs from the IMF. The Public Finance Act was amended to include contingent liabilities from SOEs in the MTBF.
Governance	
Adopt a comprehensive anti-corruption law and establish a single agency with adequate powers and independence, consolidate the anti-corruption work, and establish a track record of successful investigations and prosecutions of alleged high-level corruption.	Parliament passed the Anti-Corruption Act, which includes the establishment of an anti-corruption body. Efforts are continuing to strengthen the effectiveness and accountability of the Prosecutor's Office and to step up the fight against corruption.

Appendix II. Key FSAP Recommendations

Recommendation	Time[1]
Banking Sector Stability	
Analyze and stress test largest exposures separately, also considering potential cash flows from collateral in case of default (BNB).	NT
Financial Sector Oversight and Regulation	
Ensure adequate staffing and resources of all financial oversight authorities and arrange significant training and capacity building for staff (MoF, BNB, BDIF).	NT
Strengthen the legal and operational framework for legal protection for current and former staff of all financial oversight authorities. (MoF, BNB, FSC, BDIF).	NT
Banking Sector Supervision and Regulation	
Adopt a multi-year Action Plan with detailed activities to continue strengthening BSD (BNB).	NT
Implement a comprehensive supervisory strategy for the target banks under the AQR (BNB).	I
Introduce regulation (based on Article 45) on related parties setting criteria to typify circumvention (e.g., including the inability to identify ultimate beneficial owner, *inter-alia*) (BNB).	I
Based on 2017 inspections, enforce remedies to concentration and related party risks (BNB).	NT
Implement a risk-based approach to AML/CFT supervision in line with the FATF standards.	NT
Macroprudential Policy Framework	
Strengthen public disclosure of macroprudential policy, including the objectives and reasoning for policies and how they are supposed to work, and ex-post assessment of effectiveness (BNB).	NT
Nonperforming Loans Strategy for Banks	
Implement a comprehensive strategy for NPL reduction, including the use of supervisory review tools. The strategy should enforce (i) robust provisioning in 2017 (under IAS 39) and in 2018 (under IFRS 9), building on BCBS efforts and related supervisory guidance; (ii) oblige write-offs of NPLs where collection is unlikely; (iii) issue supervisory guidance setting out minimum collateral valuation practices; and (iv) enhance supervisory reporting and disclosure BNB.	I
Financial Safety Net	
Prioritize RRP for (1) the banks for which the 2016 AQR and stress test indicated capital shortfalls, and (2) the majority domestically owned D-SIBs. (BNB).	I
Ensure a smooth and decisive transition from early intervention into resolution. (BNB).	NT
Consistent with the currency board arrangement, define joint BNB-MoF strategies for liquidity assistance to banks, supported by a comprehensive toolkit. (BNB, MoF).	I
Under the oversight of the FSAC with an expanded mandate and membership, strengthen the crisis management framework. (FSAC, MoF, BNB, FSC, BDIF).	NT
[1] Immediately (I) is within one year, near term (NT) is 1–3 years.	

INTERNATIONAL MONETARY FUND

BULGARIA

January 31, 2018

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

European Department
(in consultation with other departments)

CONTENTS

FUND RELATIONS

(as of December 31, 2017)

Membership Status

Joined on September 25, 1990. Article VIII status assumed on September 24, 1998.

General Resources Account

	SDR Million	Percent Quota
Quota	896.30	100.00
Fund holdings of currency	798.18	89.05
Reserve position in Fund	98.13	10.95

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	610.88	100.00
Holdings	611.89	100.17

Outstanding Purchases and Loans: None.

Latest Financial Arrangements

	Date of Arrangement	Expiration Date	Amount Approved	Amount Drawn
			SDR million	
Stand By	8/6/2004	3/31/07	100.00	0.00
Stand By	2/27/2002	3/15/04	240.00	240.00
EFF	9/25/1998	9/24/01	627.62	627.62

Projected Payments to the Fund

(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2018	2019	2020	2021	2022
Principal	--	--	--	--	--
Charges/Interest	0.02	0.02	0.02	0.02	0.02
Total	0.02	0.02	0.02	0.02	0.02

Exchange Rate Arrangement:

The currency of Bulgaria is the lev. Since July 1, 1997, the Bulgarian National Bank has operated a currency board arrangement. From July 1, 1997 to December 31, 1998, the lev was fixed to the Deutsche Mark at BGN 1000 per Deutsche Mark. Since January 1, 1999 the lev has been fixed to the euro at BGN 1.95583 per euro. Bulgaria joined the European Union (EU) on January 1, 2007. Bulgaria has accepted the obligations of Article VIII, Sections 2–4, and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, aside from restrictions notified to the Fund pursuant to Decision No. 144-(52/51).

Article IV Consultations

Bulgaria is on the 12-month consultation cycle. The 2016 Article IV Board discussion took place on November 4, 2016. The Staff Report was published on November 10, 2016 (Country Report No. 16/344).

Financial Sector Assessment Program

Bulgaria received a joint IMF-World Bank mission on the Financial Sector Assessment Program (FSAP) in October 2016 and January 2017. The Financial Sector Assessment Report (FSSA) was discussed at the Board on May 22, 2017 and was published on May 23, 2017 (Country Report No. 17/132).

Technical Assistance

Bulgaria received a technical assistance on oversight and management of State-Owned Enterprises from the Fiscal Affairs Department (FAD) in FY2017.

Resident Representative

Mr. Hajdenberg is the Regional Resident Representative, based in Bucharest. He took up the position in April 2016.

RELATIONS WITH THE WORLD BANK

(As of January 12, 2018)

The World Bank Group (WBG) has been leading the policy dialogue on structural and institutional reforms in support of accelerating Bulgaria's convergence to EU income levels. On May 19, 2016 the Board of Directors endorsed the Country Partnership Framework (CPF) for Bulgaria of the WBG which outlined the roadmap for the WBG's country support for the period FY17-FY22. The CPF marks a renewed engagement with Bulgaria, including the first new lending operation since FY11. The program sets out a selective engagement with ambitious objectives in two key areas with strong government ownership and demand for the WBG support. Within these two broad areas of engagement the program identifies five objectives. The first area on "Strengthening institutions for sustainable growth" aims to: (i) Improve resilience and stability of the financial sector; (ii) Strengthen electricity sector and improved energy efficiency; and (iii) Better protect natural assets and improved efficiency in use of resources. Objectives of the second area on "Investing in people" are: (i) Enhanced school outcomes for better employability, and (ii) Improved access to essential services (housing, water, early childhood development, long-term care) for bottom 40 and marginalized groups. The objectives are strongly correlated with the WBG's twin goals of poverty reduction and shared prosperity.

A. International Bank for Reconstruction and Development (IBRD)

Bulgaria's portfolio consists of active investment projects totaling US$430 million in net commitments, which are complemented by Bank-funded analytical pieces and Reimbursable Advisory Services (RAS).

- The two active investment projects focus on the development of municipal infrastructure and the strengthening of the deposit insurance fund.
- Analytical tasks include a Spending Review with in-depth assessment of public order and safety and waste management; an assessment of Bulgaria's housing stock exposure to seismic risk; support for the enhancement of the National Program of Energy Efficiency in Residential Buildings; a road financing strategy; an assessment on how to improve access to essential services, such as education, water, housing, health and long-term care and social welfare; a study on citizen engagement; and Roma inclusion.
- There are seven Reimbursable Advisory Services (RAS) under implementation and one task is at an advanced stage of preparation. Reimbursable Advisory Services cover key areas of engagement. Under the current programming period, the World Bank is providing advice on policy formulation and strategy development in climate change adaptation; shared services; pre-university education; water and sanitation services, air quality management, forestry, and assessment of the public procurement system.

Table 1. Bulgaria: Active World Bank Operations (Net of Cancellations)

	Operation	US$ million	Board date
1.	Municipal Infrastructure Development Project	102.6	2009
2.	Deposit Insurance Strengthening Project	327.5	2016

B. International Finance Corporation (IFC)

Since the start of operations in Bulgaria in 1991, IFC has invested a total of over US$1050 million in 40 projects, including US$198 million mobilized from partners. Support was provided to the energy (wind and solar, oil and gas), retail and manufacturing (glass, steel) sectors, as well as to the banking sector in the form of trade finance. IFC will continue to play a countercyclical role through selective private sector investments. In the financial sector, this includes provision of short term liquidity and guarantees; in the real sector, this includes support for projects which contribute to the growth and competitiveness of local firms in promising sectors and which improve resource efficiency. IFC has implemented seven Advisory Services projects in Bulgaria addressing barriers to competition, developing a national corporate governance code of best practices, and addressing administrative barriers relating to on-site inspections and construction procedures. In October 2017, IFC signed a mandate for PPP advisory with the Ministry of Transport aiming to prepare the concession of Sofia Airport.

STATISTICAL ISSUES

(As of January 25, 2018)

I. Assessment of Data Adequacy for Surveillance
General: *Data provision is adequate for surveillance purposes.*
National Accounts **The National Statistical Institute (NSI) is responsible for compiling national accounts, based on the *2010 European System of Accounts (ESA 2010)*.** GDP data by activity and expenditure categories are compiled and reconciled within an annual supply and use framework. Government output and final consumption are estimated on an accrual basis. Published national accounts include production, income, capital accounts, and financial accounts for the five resident institutional sectors (general government and its sub-sectors, financial corporations, non-financial corporations, nonprofit institutions serving households, and households). **The NSI released revised national accounts estimates in September 2016, for 2000 to 2014, reflecting its latest efforts to fully implement the *ESA 2010***. Some of the key improvements to the estmates include using a market-equivalent rental approach to derive estimates of value added for owner-occupied dwellings; improving the coverage of consumption of fixed capital to include purchases of software and software produced on own-account by the general government; and improving the data sources used to derive estimates of household final consumption expenditure. Despite, these improvements, some weaknesses remain. The method used to derive taxes on products (VAT) in constant prices are not consistent with international best practice. Therefore, the changes in taxes on products in constant prices are no consistent with the changes in final consumption expenditure over time. **Labor Market Statistics** **Data on employment and hours worked are compiled by the NSI based on a Labor Force Survey and Enterprises' survey on employment**—"Quarterly survey on employees, hours worked, wages and salaries, and other expenditures paid by the employers" (QLCS) and "Annual enterprises survey on employment, wages and salaries, and other labor cost" are adjusted according to the ESA2010 methodology. The NSI current monthly and quarterly estimates are based on the results from the sample– QLCS. The QLCS sample includes 13100 private sector enterprises out of approximately 203000. The public sector enterprises are covered exhaustively except for the schools and kindergartens for which a sample is drown as well from 2008. The NSI household labor force survey provide average quarterly results and is an alternative source of

data, but the methodological discrepancies between household and establishment survey need to be taken into account (especially regarding agricultural employment).

The NSI also compiles and publishes quarterly wage data for various economic sectors. The main shortcomings include: (i) under-reporting of private sector wages; and (ii) reporting of average gross earnings only and not wages by occupation. Since 2002, a survey on earnings (Structure of Earnings Survey – SES) is conducted every four years providing information about average monthly and hourly earnings by economic activity, occupation, gender and education. The household budget survey provides an alternative source of data for private sector wages.

Price Statistics

The NSI produces a monthly consumer price index (CPI), harmonized index of consumer prices (HICP), a producer price index (PPI), and a housing price index. The CPI series began in 1995, the PPI in 2000, the HICP in 2005 (for earlier years it is set equal to the CPI), and the housing price index in 2015. The CPI's geographical coverage is restricted to 27 urban areas that account for an estimated 65 percent of sales. A monthly PPI covers the mining and manufacturing, the production and distribution of electricity and steam, and natural gas and air conditioning supply.

Government Finance Statistics

In recent years, following the recommendations of a combined STA/FAD mission and within the framework of EU fiscal reporting , the authorities have made significant progress in implementing accrual accounting for government, budgetary and statistical systems. Quarterly GFS data on an accrual basis for the general government are reported for publication in the *IFS*, through Eurostat. The major part of the GFS data is compiled by the NSI and the transmissions to Eurostat are carried out by the NSI. Since September 2008, the Ministry of Finance (MOF) prepares and submits the SDDS monthly indicators for the central government finances in the IMF's GFSM 2001 format. Since June 2016 general government operations for the SDDS Plus are prepared quarterly on accrual basis by the NSI and the BNB. High frequency data filled in Statement II (Sources and Uses of Cash) template in the GFSM 2001 format are published on the MOF's website on a monthly and quarterly basis. As of 2014, the Bulgarian statistical authorities (NSI, BNB and MoF) agreed to use the provided option by Eurostat for IMF data transmission. In this way GFS data become consistent with the ESA/EDP data not only by adding accrual data, but also in terms of scope, including all units of GG sector in accordance with ESA rules. The Bulgarian National Statistical Institute as the institution responsible for compiling GFS tables under ESA'2010 has confirmed to Eurostat to use data from ESA tables 6 and 7 (flows and stocks data of assets and liabilities) for reporting the annual GFS to IMF. The data for Statement II of the IMF GFS Yearbooks on a cash basis are still submitted by the MOF. Since 2015 it has been presented in the IMF GFSM 2014 format.

The Ministry of Finance prepares data on the execution of the consolidated government budget on a monthly and quarterly basis, following the national presentation. These data are not according to *GFS* standards. Aggregate data on revenue, expenditure, balance of the general government and composition of financing (in national formats) are published with a monthly bulletin and posted on the MOF's website, in addition to the GFSM 2001 data. Progress has been made in presenting data on a disaggregated basis, including expenditure by functional classification. In addition, a full economic classification of expenditure is now available, and the authorities have provided such data on an annual basis back to 1998.
Monetary and Financial Statistics: The BNB reports monetary data for publication in the *IFS* based on the ECB framework for the collection and compilation of monetary data, beginning with data starting in February 2004. Data comply with the *MFSM* methodology, with some minor deviations documented in the *IFS* metadata. Data for other financial corporations are not currently reported to the IMF.
Financial Sector Surveillance: Bulgaria participates in the financial soundness indicators (FSIs) project. Annual data are posted on the FSI website for the period 2005–15.
External Sector Statistics **Bulgaria provides quarterly balance of payments (BOP) statistics for dissemination in *IFS* on a timely basis.** Balance of payments and international investment position (IIP) statistics are compiled according to the *Balance of Payments and International Investment Position Manual, sixth edition (BPM6)* and reported to STA on quarterly basis. The BNB publishes monthly balance of payments data and quarterly IIP data on its official website in accordance with the Statistical Data Release Calendar. Since joining the EU in January 2007, the trade data with EU countries are being collected following the INTRASTAT system. Data for imports and exports of goods with non-EU member states are collected by Customs Agency while the movement of goods within the EU is based on Intrastat declarations collected by the National Revenue Agency. The Data Template on International Reserves and Foreign Currency Liquidity is disseminated monthly and quarterly external debt data are reported to the World Bank for re-dissemination in the Quarterly External Debt Statistics (QEDS) database. In line with the Special Data Dissemination Standard Plus (SDDS Plus) requirements, Bulgaria participates in: (i) the Coordinated Direct Investment Survey (CDIS) with inward data separately identifying equity and debt instruments positions and providing further breakdown of gross asset and liability debt instrument positions; (ii) the Coordinated Portfolio Investment Survey (CPIS) providing semiannual core data as well as the following encouraged items: currency of denomination, sector of the holder, liabilities, sector of the issuer, and cross-sectors classifications; and (iii) the Currency Composition of Official Foreign Exchange Reserves (COFER).
II. Data Standards and Quality
Bulgaria started to adhere to the SDDS Plus in 2016.

Bulgaria: Table of Common Indicators Required for Surveillance
(as of January 25, 2018)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]
Exchange Rates	1/08/2018	1/10/2018	M	M	M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	November 2017	1/19/2018	M	M	M
Reserve/Base Money	November 2017	12/27/2017	M	M	M
Broad Money	November 2017	12/27/2017	M	M	M
Central Bank Balance Sheet	November 2017	12/27/2017	M	M	M
Consolidated Balance Sheet of the Banking System	November 2017	12/27/2017	M	M	M
Interest Rates[2]	January 2018	1/25/2018	M	M	M
Consumer Price Index	December 2017	1/12/2018	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	2016	10/25/2017	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]– General Government[4]	November 2017	12/29/2017	M	M	M
Revenue, Expenditure, Net operating balance, Gross operating balance, Net lending/borrowing, Net acquisition of assets, Net incurrence of liabilities [5] – General Government	2017 Q2	10/25/2017	Q	Q	Q
Revenue, Expenditure, Balance, Net acquisition of assets, Net incurrence of liabilities, Net change in the stock of cash [5] – Central Government	November 2017	12/29/2017	M	M	M
Stocks of General Government and General Government-Guaranteed Debt[6]	November 2017	12/29/2017	M	M	M
External Current Account Balance	November 2017	1/19/2018	M	M	M
Exports and Imports of Goods and Services	November 2017	1/19/2018	M	M	M
GDP	2017 Q3	12/05/2017	Q	Q	Q
Gross External Debt	September 2017	11/28/2017	M	M	M
International Investment Position	2017 Q3	11/28/2017	Q	Q	Q

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] On a gross cash basis. The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and local governments.
[5] Indicators presented in adherence with the SDDS Plus.
[6] Including currency and maturity composition.
[7] Monthly (M); Quarterly (Q); Annually (A).

Statement by Anthony de Lannoy, Executive Director for Bulgaria and Tsvetan Manchev, Advisor to the Executive Director
February 14, 2018

The Bulgarian authorities thank the Article IV mission team for the constructive discussions in Sofia, well-balanced appraisals, and for the elaborations in the Selected Issues Papers. Encouraged by staff's acknowledgement of the country's solid performance and resilience, they remain committed to prudent macroeconomic and financial policies. The authorities broadly concur with the staff's recommendations which will be carefully considered to address the challenges to the Bulgarian economy.

The new coalition government, which took office last May, is dedicated to boost competitiveness and growth potential by strengthening the public finance management, accelerating the EU funds utilization, and improving the business environment. In line with the recent FSAP recommendations, the concerted efforts of the Bulgarian National Bank (BNB), Financial Supervisory Commission (FSC) and government have resulted in substantial progress with strengthening the financial stability framework. Several legislative initiatives have been introduced, while other steps are being prepared, including implementation. We will focus our remarks on (1) financial stability, (2) fiscal sustainability, and (3) structural reforms and growth.

Financial Stability

Without complacency, the authorities continue to address the remaining financial stability risks. In line with the recent FSAP recommendations, they have made substantial progress with strengthening the institutional framework for the financial system oversight and operationalizing systemic banks resolution and crisis management. As pointed out in the staff report, several legislative initiatives have been introduced, while other steps are in preparation, including implementation. The recent changes in the BNB legislation transferred the supervisory powers from Deputy Governors to the BNB Governing Council, and the BNB is working to quickly put in place decision making rules and procedures adequate to the new governance model. It is envisaged to become fully operational in the course of this year. The FSC Act was also amended to make the regulator fully financially independent and more accountable. The FSC is the competent authority for the recently transposed EU Directive on Markets in Financial Instruments (MIFID II) into the Bulgarian legislation. New rules for admission to trading of government securities were adopted, and an electronic platform was introduced to increase transparency and limit the clearing and settlement risks.

In line with recent FSAP recommendations, the BNB has already implemented a number of policies to strengthen financial stability and increase confidence in the financial system. The plan to promote risk-based supervision, including the risk-based AML/CTF approaches, has been evaluated and regularly been updated by the governing council to accommodate important developments in the financial sector reform at the

European level. The banking supervision has completed a comprehensive assessment of the banks' credit rules and procedures and their ability to implement the IFRS 9. The new standard should strengthen the individual banks' capacity for risk assessment and asset classification, and reinforce the collateral evaluation and provisioning in line with the best recommended international practices. Now, the BNB remains focused on making the bank resolution framework fully operational. The BNB continues to proactively develop the macroprudential framework and has enhanced its capacity to analyze and address the systemic risk. With regards to the non-banking financial system, the FSC has made the next steps to implement the European Solvency II Directive in the insurance sector, and strengthen portfolio quality and capital buffers of the insurers and pension funds in line with the outcomes of the 2017 comprehensive asset quality reviews (AQRs) and stress-tests of insurers.

The Bulgarian banking sector remains profitable, well capitalized, and highly liquid, since credit growth has steadily recovered and the NPLs declined from 17.2% at the end of 2014 to 10.2% at December 2017. Since 2016 bank profits have returned to pre-crisis levels, and all banks have firmly observed the regulatory standards for accumulating various capital buffers. Following the results of the 2016 AQRs and stress tests, some banks have successfully implemented recovery plans to achieve the supervisory targets above the minimum regulatory capital. Potential spillover risks from the Bulgarian banking system remain well contained thanks to the stable domestic deposit funding and low reliance on both the domestic and international wholesale financial markets. Supported by the BNB, market-driven changes in the ownership structure of the Bulgarian financial sector continue to take place, and at the beginning of this year the "Municipal Bank PLC" has been privatized to European investors.

<u>Fiscal Sustainability</u>

Bulgaria has implemented conservative fiscal strategies since the adoption of the Currency Board Arrangement (CBA). Like in the previous year, the 2017 fiscal consolidation appeared to be faster than initially anticipated due to higher economic growth, further strengthening of the revenue collection framework, and under-execution of the capital spending. The government saved the revenue's overperformance to strengthen fiscal buffers and contain cyclicality of the private demand. They accordingly adjusted the medium-term fiscal target, and will return to a structurally balanced budget by 2020, which enables the automatic stabilizers to work while the government builds up liquidity buffers in good times and contains further debt accumulation. The 2018 budget projects a cash deficit at 1 percent of GDP, and the structural budget deficit will remain at about 0.5 percent to GDP. The 2018 tax policy remained broadly unchanged in line with the long-standing authorities' commitment to maintain a predictable low-tax environment. Given the long-term challenges to the pension system, however, from the beginning of 2018 the social security contribution rate was increased by one percentage point.

The authorities remain vigilant to the potential medium- and long-term fiscal pressures. Last year, supported by IMF Technical Assistance (TA), they started developing a framework to better identify and manage fiscal risks stemming from the state-owned enterprises. Corresponding amendments to the Public Finance Act were made to include their contingent liabilities into the medium-term budgetary framework. The national energy and water regulator also implemented series of measures to bring the utility prices firmly on the cost recovery path and ensure better quality of the services. In 2018, the IMF TA will support the Bulgarian national revenue agency to improve the tax gap assessment process. Together with the World Bank, the authorities are conducting a public spending review in several areas. Depending on the success in the following years, the scope of the project will be extended to other areas. As described in the staff report, the next steps in the public education reform will be implemented to achieve a more targeted and efficient public expenditure and to further enhance the productivity of public investment.

Structural Reforms and Growth

The Bulgarian macroeconomic fundamentals grew significantly stronger after the global crisis thanks to the firm national consensus to the CBA and the government's strong underlying fiscal position. These remain the anchors for all other macroeconomic policies in the long run to make a steadfast progress with the EU income convergence. In addition, the new coalition in power since May has made decisive efforts to increase public awareness in the needed structural and institutional reforms, and to consolidate public confidence and reinvigorate the reform process. In January 2018 the Bulgarian parliament adopted the new Counter-Corruption and Unlawfully Acquired Asset Forfeiture Act to better coordinate the fight against corruption. They consider this key to enhance the business environment and facilitate a smooth transition toward a sustainable investment- and export-driven growth model.

The cyclical economic recovery accelerated further in 2017 given the improved domestic business confidence after the elections, robust growth of the European economy, and surge in the global trade. Inflation has steadily recovered, and the unemployment rate has reached its lowest level since the global financial crisis. Initial estimates indicate that the 2017 GDP growth may approach 4 percent, higher than initially anticipated by staff and the authorities. It was primarily driven by private consumption, which also contributed to an increase in imports. Government consumption had a broadly neutral contribution to growth, and its dynamics were determined by the rate of increase in compensation-per-employee in budget organizations, operating expenditure and health insurance payments. The improved external demand led to a significant increase in exports and tourism receipts, which resulted in a close to nil contribution of net exports to real GDP growth. To sustain growth momentum, the government adopted the 2018 National Employment Action Plan with a series of measures to strengthen the labor participation and re-inclusion in the labor market of the long-term unemployed.

The authorities broadly share staff's view on outlook and risks, but they believe the upside risks can be better tailored in the medium-term baseline scenario. In line with expectations of improving global economic activity, the external demand for Bulgarian export is likely to continue growing. If market expectations materialize, the terms of trade will remain favorable. Investors' interest in Bulgaria and the region has also recovered on the back of the favorable global economic outlook and the recent substantial infrastructure investments. The Bulgarian business climate index rose by another 2.6 points m/m in January on the back of improving confidence in all the economic sectors. The business surveys suggest that 2018 will be stronger in terms of demand for industrial plots and the upcoming investments are planned in a broad spectrum of sectors – from food and textile, to high tech, car parts and machinery industries. Steady improvement of the EU funds absorption and the credit expansion gaining momentum will help investment growth in Bulgaria too. Going forward, positive effects on both domestic demand and potential output stem from the second-round effects of gradual fiscal consolidation in recent years. It is encouraging that now the investors' radar includes regions with high unemployment. There have also been initial signs that Bulgarians started gradually returning from abroad, but the income convergence will be key to intensify this process.

The new government has demonstrated high determination to make up for delayed structural reforms. Priority has been given to various legislative initiatives under the Cooperation and Verification Mechanism (CVM) with the EU to give impetus of the juridical reforms. The most important development in 2017 were the election of a new Supreme Judicial Council to boost independence and efficiency of decision-making in the judicial system, and the adoption of amendments in the Judicial Systems Act and Criminal Procedure Code to improve the legal framework for prosecution of high-level corruption and serious organized crime. In line with the most recent recommendations under the CVM, the remaining legislative initiatives will be brought forward in a spirit of a broad public debate and consultation with affected stakeholders. By the end of March 2018, the government will also introduce a roadmap for transformation towards an e-government with clear funding, dates and strategy. A new model for the registration, operation, management and funding of medical care is developed to increase cost efficiency and improve the service quality. After the public debate, the authorities will prepare the relevant legislative changes, and the system would be ready to start operating under the new model from January 1, 2019. They also forcefully consider measures to tackle air pollution in the big cities, and make public transportation more efficient and environment-friendly.